The Economist

It's the economy, boss

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Politics this week

Jul 25th 2002
From The Economist print edition

A blow to peace

Reuters

Israel bombed a residential area in **Gaza city**, killing Salah Shehada, Hamas's military leader, plus 14 other people, including nine children. Ariel Sharon called the operation a great success, though regretting the innocent casualties, but some members of his government admitted to a mistake. Outsiders, generally, deplored the action and the Palestinian military factions vowed revenge.

See article: The Middle East

The **Sudanese** government and the Sudan People's Liberation Army agreed to a framework for ending their long civil war. The deal involves sharing power over a six-year transitional period, after which southern Sudan would vote on self-determination. The details are to be worked out at a further meeting next month.

Congo and **Rwanda** also struck a deal to end fighting in eastern Congo. But the deal's success still depends heavily on the UN being able to remove the causes of conflict.

See article: On Sudan's horizon, and maybe Congo's

Fighting between rival **Somali warlords** in Mogadishu killed at least 16 people. Tension is high ahead of forthcoming peace talks to take place in Kenya.

War on drugs

Republicans and Democrats blocked each other's plans in the American Senate to help the elderly pay for **prescription drugs**. A temporary measure may still emerge but reform must wait until after the mid-term elections, in which prescription drugs will be a big issue.

Bowing to pressure from **anti-abortion** Republicans, the State Department diverted a $34m contribution earmarked for the UN's Family and Population Fund to the department's own Agency for International Development.

See article: Mr Bush's problems with the UN

The House of Representatives voted to expel James Traficant from Congress; the Democrat was convicted on **bribery and racketeering** charges in April. He is only the second congressman to be chucked out since the civil war.

See article: Jim Traficant is expelled from the House

AP

Governor Gray Davis signed a law to restrict the emissions of carbon dioxide and other **greenhouse gases** from cars and trucks in California from 2009. California is the only state empowered to set its own pollution standards.

See article: California v greenhouse gases

Montevideo nasty

Uruguay's dire economic crisis deepened: the tiny country's reserves fell sharply to less than a third of their value at the start of the year. President Jorge Batlle was forced by panicking coalition leaders to sack his finance minister, Alberto Bension.

See article: Uruguay's economic misfortunes

The fortunes of Ciro Gomes, a candidate for **Brazil's** presidency and a former finance minister, rose: his poll rating surged to 21%, surpassed only by the left-wing candidate, Luiz Inacio Lula da Silva. Financial markets were unimpressed and the *real* slumped to an all-time low.

See article: The rise of Ciro Gomes

An official report revealed that over 200,000 people in rural **Peru** were pressured into being sterilised by the government of Alberto Fujimori, a former president.

Greek round-up

Greek police arrested ten foot-soldiers of the November 17 terrorist group and its alleged intellectual leader, a French-educated professor. But, seemingly, no high-ups among the gunmen themselves.

Poland's cabinet endorsed a plan by its new finance minister, Grzegorz Kolodko, to write off arrears owed by ailing companies to the state, in return for a 15% “restructuring payment”. The aim: to restart its economy, now stagnating with 17% unemployment.

See article: Reviving Poland's economy, maybe

A new coalition government took office in the **Netherlands**, led by Jan Peter Balken-ende, a Christian Democrat. A Fortuynist got the ministry responsible for immigrants, a Liberal that of finance.

Britain's government proposed a huge increase of **airport capacity**, and possibly an entire new airport, in southern England. Stand by for a huge new row over that crowded area's environment.

See article: Britain's new airports

Italy's President Carlo Azeglio Ciampi sent parliament a message calling for a new law to guarantee plurality of media ownership. It was countersigned by its obvious target, the prime minister and media tycoon Silvio Berlusconi.

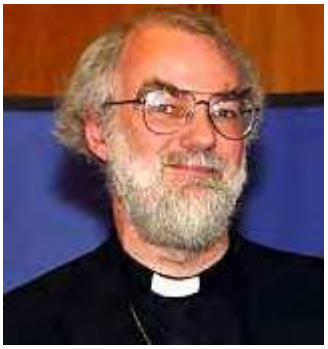
See article: Italy's media and politics

The **Anglican church** worldwide got a new head—proposed by Britain's prime minister and appointed by its queen. Rowan Williams, a progressive in church and social terms, is to be the new Archbishop of Canterbury.

AP

See article: The new archbishop of Canterbury

Spain withdrew its soldiers from disputed Perejil island and agreed with Morocco that neither side would send more there.



Kashmir simmers

Rejecting Pakistan's claims that rebel incursions have ended, India blamed its neighbour for guerrilla attacks in Indian-controlled **Kashmir** which killed four and left 30 injured. The American secretary of state, Colin Powell, is due to visit the region this weekend.

Vietnam's National Assembly voted to retain the state president, Tran Duc Luong, and reformist prime minister, Phan Van Khai. The assembly's chairman, Nguyen Van An, was also re-elected.

The government imposed a ceasefire after fighting broke out in western **Afghanistan** between ethnic Pushtun and Tajik gunmen in the province of Herat, killing at least 12.

Abdul Kalam, a former rocket scientist and also a Muslim, was sworn in as **India's** 12th president.

Reuters

Torrential monsoon rains have caused flooding and landslides in **Nepal** and **India**, killing more than 100 and leaving at least half a million homeless.

India's minister for human resources strongly objected when his country, the world's largest democracy, was ranked 124th out of 173 countries in the latest UN Human Development Report. He said the report might have been based on purely material development, ignoring spiritual happiness and intellectual advances. The 27 least-developed countries are all in Africa, the report said.

See article: World Poverty

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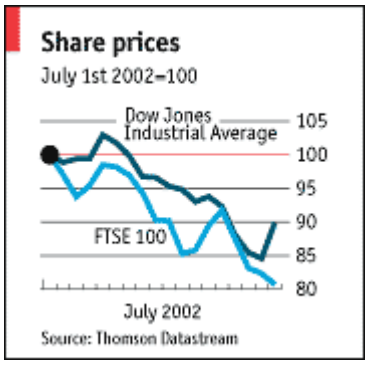
Business this week

Jul 25th 2002
From The Economist print edition

End of the WorldCom?



Despite reassuring utterances from President George Bush on the health of America's economy and words of supposed comfort from Paul O'Neill, the treasury secretary, American **stockmarkets** fell before rallying strongly midweek. Stockmarkets around the world followed suit.

See article: America's Economy

WorldCom secured the dubious honour of becoming the biggest-ever corporate bankruptcy. The American telecoms company, under investigation for an accounting scandal that overstated profits to the tune of $3.9 billion, filed for Chapter 11 bankruptcy protection but promised customers that its services would be unaffected.

See article: The only way is up

AOL Time Warner admitted that the SEC was probing its accounting practices over the past few years. The group also reported its first quarterly net profit since its merger. Earlier it had shed an architect of the merger, Bob Pittman, from his job as chief operating officer.

See article: Reining in AOL

J.P. Morgan Chase and **Citigroup** became further embroiled in the Enron scandal. Shares in the two banks plunged after congressional investigators found that their “active participation” had assisted Enron's financial manipulations. Both banks insist that they did nothing illegal and their shares later rallied.

See article: Citigroup and J.P. Morgan Chase under scrutiny

John Rigas, two of his sons and two other former executives were arrested in connection with a massive fraud at **Adelphia Communications**, the cable company Mr Rigas founded. They are accused of using the now-bankrupt Adelphia as a “personal piggy bank”. The Rigas family used some of the ill-gotten funds to build their own golf course.

The two houses of Congress agreed on a **corporate and accounting reform bill** that broadly followed the tougher Senate version proposed by Paul Sarbanes. George Bush promised to sign the bill swiftly.

See article: A bill passes on corporate reform

Call charges

AT&T announced losses of $12.7 billion for the second quarter. The American phone company took a charge of $13.1 billion to match the plummeting value of assets at the same time as revenues fell. The only good cheer: a chance to pick up customers fleeing from WorldCom.

Losses at **Lucent Technologies** amounted to $7.9 billion in the quarter, after a charge of $5.8 billion related to a change in accounting rules for deferred tax. Spending on telecoms equipment has failed to pick up. Lucent said it would have to get rid of 7,000 employees, some 13% of the total.

Jean-René Fourtou, new boss of **Vivendi Universal**, announced plans to reduce the company's mountainous debts. A break up of Canal Plus and a sell-off of its international operations should raise some $2 billion. Mr Fourtou promised further “significant asset sales” to revive Vivendi's flagging fortunes.

Cruise control

The sea battle between the world's three biggest cruise lines steamed ahead. A decision by the European Commission to permit a $5.5 billion takeover of Britain's **P&O Princess** by America's **Carnival** was strongly criticised by America's **Royal Caribbean Cruises**, a suitor with a smaller offer on the table. American regulators have yet to opine on the merits of the two offers.

Amazon joined the trickle of companies that will voluntarily treat stock options as expenses on their profit-and-loss accounts. The online retailer also announced that it had cut losses in the latest quarter by 44% over a year ago, to $94m.

Diageo appeared near success in the slow task of selling its Burger King fast-food chain. The sale will probably be to a group headed by Texas Pacific, an American private-equity firm, for some $2 billion, after rival bidders fell away.

The Hershey foundation is considering a public auction of **Hershey Foods**, America's biggest confectioner, which it controls. A sale requires board approval. Possible buyers include Unilever, Nestlé or Cadbury Schweppes.

Aegon, a Dutch insurer, issued a profits warning that sent its shares down by 18%. The company blamed falling stockmarkets, bond defaults and a falling dollar. European insurers with similar problems also suffered. Aegon also reportedly expressed interest in buying 50% of Sony's Japanese life-insurance business for up to ¥100 billion ($860m).

David Komansky is to step down as chairman and chief executive of **Merrill Lynch**, a year early. Stan O'Neal will take over both roles at the investment bank.

Pursuing its plan to become an international oil major, Brazil's **Petrobras** launched a $1.1 billion bid for a controlling stake in **Perez Companc**, an Argentine energy group.

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The travails of George Bush

It's the economy, boss

Jul 25th 2002
From The Economist print edition

George Bush is losing control of the American political agenda

Reuters

CAN it really be happening again? A decade ago, George Bush senior let a seemingly simple re-election slip out of his grasp, as economic problems and a perception that the president was out of touch obscured his triumphs abroad. Now the son for whom that defeat was a cataclysmic experience also appears to be drifting, as the war against terrorism has given way to corporate scandals, falling stockmarkets and the idea that a rich Republican president is out of touch.

George Bush junior is not in as bad a fix as his father was—not least because he does not face re-election for another two-and-a-half years. But he is still in a fix. The man who promised to clean up Washington, DC, now finds his press conferences dominated by corporate shenanigans at Harken Energy (where he was a director) and Halliburton (where Dick Cheney was boss). His reaction to America's "crisis of capitalism" has been derided as meek. His attempt to calm the stockmarkets has failed. His huge tax cut has helped push the government into deficit. Abroad, his allies have sniped at Mr Bush about his policies towards Afghanistan, Arafat and agriculture (just to name things beginning with A).

The Democrats now talk confidently of taking back the House of Representatives in the November mid-term elections, giving them control of Congress (see article). It would be foolish to be certain of this: the Republicans might, for instance, lose the House but regain control of the Senate, where local personalities matter more. But the fact that voters will receive their ravaged 401(k) pension statements in October will not help Mr Bush's troops.

Even without a Democratic Congress, the legislative agenda seems to be slipping away from the conservative ideals he once trumpeted. All the current proposals seem to be about increasing the scope of government. Of course, some of the new bureaucracy stems from security measures; but the shift to bigger government ranges from prescription drugs to farmers. The notion of Mr Bush now steering through anything with the scope of his tax cut or his education bill seems remote. All in all, the impression is of a presidency on the defensive—and considerably smaller than it once seemed.

This unflattering image is partly a trick of perspective. Back when Mr Bush began his presidency, the idea that he might lose control of Congress in the mid-term elections was close to accepted wisdom. Presidents tend to get clobbered after a couple of years; Ronald Reagan bounced back emphatically from a poor result in 1986, Bill Clinton from a catastrophe in 1994. Only a year ago, Mr Bush was in a pickle, after the defection of Senator Jim Jeffords handed the upper chamber to the Democrats. Step back a little, and the "extraordinary" part of Mr Bush's presidency is not the current downturn in his political fortunes, but the surge that occurred after September 11th. And he still keeps a bit of that shine: even now, his approval ratings remain comfortably positive. Imagine, just for the sake of argument, that the economy were to keep growing and Mr Bush were to depose Saddam Hussein by next summer. In that case, he could well romp to victory in 2004.

That is possible. Yet Mr Bush would be foolish to take too much comfort, for two reasons. First, politics is about momentum, and for the moment he is rolling downhill. Though it is easy to imagine him recovering triumphantly from his current predicament, it could also get worse. The economy could follow the

Politics is about momentum, and for the moment

stockmarket (see article). The probes into Mr Bush's and Mr Cheney's past could turn up something nasty. The war against Iraq could go badly, or it could be delayed by events in the Middle East, where his current peace “plan” looks ever less adequate. And, second, his current poor showing is not just a matter of political spin; it reflects real disappointments.

Mr Bush is rolling downhill

The disappearing presidency

The Economist endorsed Mr Bush two years ago, and we have given strong support to America's war against terrorism. After September 11th, he proved a brave leader, sometimes magnificently patient and determined, surpassing this newspaper's expectations of how he might handle such a crisis. But there have also been disappointments. His economic policy has too often been amateurish and rigid. His fiscal policy still seems to be based on making his gigantic tax cut permanent after 2010 rather than worrying about stimulus now. His trade policy—notably his steel tariffs and farm subsidies—has been discouraging. Abroad, his foreign-policy successes have been undermined by a needlessly self-centred strain: allies have been pointlessly antagonised, domestic lobby groups cravenly indulged (the UN was the target, this week, again—see article).

From this perspective, “gridlock”, with different parties in charge of the Congress and White House, might not be bad for America. A Democratic Congress might enlighten a few of his more blinkered urges in foreign policy and may even bring his economic policy into line—though it would be unlikely to help on trade. In a perfect world, Mr Bush would veto Democratic spending splurges, while the Democrats stopped more tax cuts (though they could both indulge the other's weakness). But there are things that Mr Bush plainly needs to do sooner.

“Gridlock”, with different parties in charge of Congress and the White House, might not be bad for America

The priority has to be the economy. Signing a just-passed bill that will regulate auditors more closely (a drive Mr Bush should have led, not resisted) is not enough. As *The Economist* went to press, the White House was making a belated push to get “fast-track” trade promotion authority through Congress. It is also clear that he needs to change his economic team, which has no steadying figure to match, say, Donald Rumsfeld at defence. Holding the line on spending will be extremely hard, not least because of Mr Bush's own profligacy.

And the war against terrorism? This, more than ever, seems the heart of the Bush presidency. Mr Bush has enjoyed wide support at home and abroad, largely because he has generally been seen to be acting in the interests of the whole world. Soon the issue of Iraq will present itself. Any well-founded impression that the timing is governed by domestic political concerns would be ruinous. The Bush presidency can cope with a little fading; it cannot cope with a general perception that it cares only for its own survival.

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North Korea

Open sesame

Jul 25th 2002
From The Economist print edition

Communist North Korea appears to have taken its first small step towards a market system

Get article background

IT IS wholly characteristic of the world's most secretive state that it has marked what is potentially the biggest shift in its political history with complete official silence. Yet the evidence is compelling. As our visiting correspondent reports from Pyongyang (see article), on July 1st North Korea began what looks very like an attempt to move wages and prices from a workers'-paradisiacal near-zero to something more closely aligned with market levels. The price of rice, for instance, has leapt 400-fold since the beginning of the month—though it was in effect free before. Diesel is up 40-fold; electricity 60-fold. People are starting to have to pay rent. Wages have risen sharply, too, by perhaps a factor of 20.

What, though, does all this mean? Since these striking events have gone entirely unremarked in North Korea's official media—the big news this week being a request from an "unconverted long-term prisoner" that Chairman Kim Jong Il choose a name for his baby daughter—and since foreigners are hardly ever permitted to visit the Hermit Kingdom and are tightly circumscribed when they do, it is not at all easy to say. But it would surely be premature to say that the world's last Stalinist state has embraced Adam Smith. There is more to a market system than merely adjusting prices to more sensible levels. And the fact remains that even after the increases, that litre of diesel still costs about 80 cents at the official exchange rate, or more realistically 0.8 cents at the (black) market one.

Will there be continued progress towards allowing the market actually to determine prices rather than just influence bureaucrats a bit? Will the state allow the supply side of the economy to grow—to take the most necessary instance, by expanding the still-tiny farmers' markets which allow the sale, at market prices, of privately grown produce? If not, unleashing demand will simply fuel appalling inflation. Will other forms of private enterprise, currently non-existent, be permitted? To be honest, no one knows.

Will the state allow the supply side of the economy to grow? If not, unleashing demand will simply fuel appalling inflation

Even without knowing, though, it is still possible to hope. The changes—one hesitates to call them reforms as yet—do at least imply that North Korea's leaders realise that they face a serious problem, and understand, however dimly, that the solution must have something to do with markets. Other encouraging signs include the limited opening of the country to foreign businesses—and even the appearance of the first-ever North Korean internet café, with a mobile phone network supposedly soon to come. It used to be an offence in North Korea to own a short-wave radio.

This change has a precedent, of a kind. The conversion of China from a form of communism every bit as austere as North Korea's state ideology of *juche* (self-reliance) to its present economic state of near-capitalism likewise began in 1978 with tentative steps in the field of basic commodities. In China, though, Deng Xiaoping realised from the start that the supply side was what mattered, and so made large tracts of land available to private farmers. If he is wise, Mr Kim, the "peerless leader", might reflect that 25 years on, the embrace of capitalist techniques has yet to result in the overthrow of China's Communists, whereas Romania's Ceaucescu, who eschewed economic reform, was shot.

Trust, but verify

North Korea's small experiments, therefore, deserve a warm welcome. But that should not allow the world to close its eyes to the character of the regime in Pyongyang. North Korea remains one of the world's most dangerous countries, with the world's third-largest army, large supplies of sarin gas and the smallpox virus, advanced missile technology (which it readily exports to dubious buyers in return for badly needed hard currency), and, in all likelihood, a supply of plutonium. Its political culture is deeply imbued with antagonism towards America, Japan and South Korea, and most of its huge army is within shelling distance of Seoul, the South's capital. Engage with North Korea by all means—and since 2000, American companies have been free to do business there, while most European countries now have diplomatic relations with Pyongyang—but the pressure must not be eased until these problems have been addressed.

For 18 months now, dialogue between the United States and North Korea has been more or less on hold, though a relatively junior American official has met North Korean delegates. The North Koreans blame the hostility of George Bush, as evidenced by their country's inclusion in the president's “axis of evil”. The Americans blame North Korean unwillingness to take up Mr Bush's offer of talks. A senior State Department official, James Kelly, had been due to visit early in July, but it was never made clear whom he would see, and the talks were anyway called off (by the Americans) following a naval clash in June between North and South Korea. Encouragingly, the North this week expressed “regret” over the clash. But though it is important that these talks restart as soon as possible, this will be worth doing only if North Korea agrees to discuss the full range of issues that cause alarm.

Mr Bush's Korea policy has been much criticised. But the Clinton approach that preceded it was flawed. It centred only on the question of missile proliferation, and did not manage to get close to putting in place an effective verification system for the planned deal. Mr Bush is right to insist that establishing what happened to North Korea's plutonium in the 1990s, and agreeing confidence-building measures for the vast conventional military deployments along the “demilitarised” zone, matter just as much if relations between America and North Korea are ever to be normalised.

Engage, then, but never fight shy of tackling the difficult issues. Does that sound familiar? It is, more or less, the policy that America has adopted towards China in recent years—promoting investment and all kinds of exchanges, while talking tough about rockets, nukes and human rights; and insisting on firm, verifiable agreements, whether they be the rules of the World Trade Organisation or of the Missile Technology Control Regime. That formula, which this paper once dubbed “constrainment”, may soon be right for North Korea.

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Central Asia

The rot in Kazakhstan

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From The Economist print edition

How western firms could help western diplomats to buttress a failing democracy

Get article background

THESE ought to be good times for Kazakhstan. With every prospect of becoming one of the world's main energy exporters in the next 20 years, and a population of only 15m sprawled over a territory five times the size of France, this lucky Central Asian country should be preparing for a prosperous, democratic future.

Instead, President Nursultan Nazarbaev is turning the screw with a toughness that has astonished even the most jaded observers of the region. Over the past two weeks, a law has gone into effect that makes it all but impossible (by requiring a very high number of signatures) for independent political movements to register. Of the 19 parties that now exist, only three pro-presidential ones are expected to survive.

Mukhtar Ablyazov, a media baron and former energy minister, has been jailed for six years after a trial in which due process was ignored; and another opposition figure, Galymzhan Zhakiyanov, is on trial amid ominous reports that his health has suffered in detention. Newspapers and television stations have been closed, and journalists harassed in a bid to quash a new opposition force that emerged last year.

As political authority is concentrated in the hands of the presidential family and a handful of advisers, the western nations that had seen in Kazakhstan a vital strategic partner are embarrassed. There have been protests from America's State Department and other western institutions.

But how sincere are these protests, and how far should they be pressed? Cynics might argue that from the West's viewpoint, the biggest event of recent weeks in Kazakhstan was an agreement to allow stop-overs by American fighters at the country's military airports; this should be a useful back-up to the new western base in nearby Kirgizstan. With such enticing strategic prizes—as well as vast resources—at stake, should the West be worrying about Kazakhstan's internal affairs?

Should the West be worrying about Kazakhstan's internal affairs? It should, for there is much to lose

In fact, there is a tough, pragmatic case to be made for worrying quite a lot. It is not in the interests of anyone in Kazakhstan—not even, save in the very short term, in the interests of its political rulers—to see the republic's promising start as a liberal democracy come to an end. In the immediate future, Mr Nazarbaev may succeed in neutralising his foes. But as power becomes less accountable, there is a risk that more and more of Kazakhstan's energy revenues will be salted away to secret, overseas places; and that all its hopes of becoming a vibrant, extrovert, multi-ethnic society will be dashed. Only a few years ago, Kazakhstan was winning plaudits for its multi-party system and open economy; it will be a tragedy if the country's early promise gives way to Soviet-style repression.

To avoid this outcome, diplomatic protests may not be sufficient; they have often been ignored. At a time when business ethics are under scrutiny all over the world, western firms and their shareholders should be asking whether the cosy ties they have established with elites in several ex-Soviet states have abetted arbitrary rule—while incurring the risk of a torrent of anti-western protest when power finally changes hands.

George Soros, an investor and philanthropist, has suggested that energy and mineral companies agree on a code of conduct to govern their relationships with resource-rich states in the former Soviet Union and elsewhere. Western firms should take heed; they would be practising a sophisticated form of self-interest if they used their influence to promote good governance, rather than the opposite, in Central Asia.

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Stockmarkets

Bear days of July

Jul 25th 2002
From The Economist print edition

Investors are learning painfully that high returns come only with high risks

WHEN America's president starts advising investors that there is value to be had from buying equities, it may really be time to panic. On three separate occasions George Bush, acting in the best Hoover traditions of 1929-30, has tried to reassure jittery stockmarkets by praising the economy's healthy fundamentals. Each time he has spoken, Wall Street has responded by falling heavily. This month alone, the narrow but widely followed Dow Jones Industrial Average had tumbled by almost a fifth before its sudden 6.5% rebound on July 24th. Since Mr Bush took office in January 2001, the broader S&P 500 index is down by 40%. It is now some 45% below its peak of early 2000, making this on some measures a deeper bear market than 1973-74 (and thus the worst since the 1930s).

As far as investors are concerned, a period of silence from Mr Bush, as well as from his itinerant treasury secretary, Paul O'Neill, who has just as hamfistedly tried to talk up equity prices, would now be welcome. Yet the Bush administration is hardly to blame for the markets' woes. The late 1990s bubble under its predecessor pushed share valuations so high that its bursting was bound to cause pain. Most of the recent cases of corporate wrongdoing and accounting scandals that have further dented investors' confidence also date from the Clinton era. In any case, falls in equity prices are not restricted to America. Since their peaks in 1999-2000, stockmarket indices have fallen by almost half in Britain and continental Europe too.

What investors want now is not waffly presidential reassurance but the answer to a simple question: is this two-and-a-half-year-old bear market nearly over? Sadly, there is reason to think that the answer may be no (see article). Trading volumes have been heavy and outflows from equity mutual-funds have picked up sharply. But there has not been much sign of the mass panic-selling that so often marks a market bottom. Just as important, on most valuation measures such as price/earnings ratios, stockmarkets, even though well down from the overvaluations of the late 1990s, remain expensive. And there are grounds to doubt that all the bad news about misleading accounting or heftier-than-admitted debt burdens has yet emerged; fresh trouble could hit banks and insurance companies especially hard.

Realism amid the gloom

What about the health of the economy? Here it is fair to say that it looks more robust than might have been expected last autumn. The Federal Reserve has just raised its forecast of likely GDP growth in America this year. Profits—if investors believe them any more, a genuine concern these days—are recovering quite strongly from last year's troughs. But the slide in equity prices does signal rising uncertainty about the durability of the economic recovery. More worrying, the markets' jitters could sap consumer and business confidence so much as itself to jeopardise that recovery—turning investors' pessimism into a self-fulfilling prophecy.

It might seem as if all the news from the stockmarkets is bad, or potentially so. Yet one good thing is coming out of the popping of the bubble. Investors, whether they be pension funds, insurers or individuals, are at last coming to take a more realistic view about plausible levels of future returns.

One damaging consequence of the unusually long bull market after 1982 was

the illusion it fostered that double-digit real returns were easy to make without running high risks. Theorists sprang up to claim not just that there was a “new economy” but that, contrary to all previous wisdom, equities were even less risky than government bonds. That, it was argued, justified a higher level for the stockmarket than historical valuation measures seemed to warrant (see article).

Investors are at last coming to take a more realistic view about plausible levels of future returns

The experience of the past couple of years has poured chilly water on such theories. Yet many investors have been slow to abandon their dreams of risk-free, double-digit returns. When equities failed them, they tried bonds, or more recently hedge funds, though these too have proved unrewarding (see article). Now some optimistic investors hope that property might produce the same generous and safe returns as equities did in the 1990s.

They are destined to be disappointed. For this bear market has confirmed one of the oldest truths of investment: high returns are to be made only by taking high risks. Since most investors, concerned about their pensions and future living standards, are unwilling to run such risks, they are learning to settle for lower returns (and having to save more) than they had assumed over the past decade or so. That is at least returning the financial markets to a healthier and more balanced normality—even if the lessons are proving painful.

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Motor sport

Achtung, Schumacher

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There's the rest, and then there's the winner

Reuters

HE IS undoubtedly a bully to new kids on the track. There have been times when some reckoned him a cheat. Watch him through the lens of an overhead camera, and he proves conclusively that the art of winning is indeed to cut corners. And he's the winner armchair critics, especially in Britain, love to hate. But this week, as he took his fifth world title, Michael Schumacher's detractors could but fall dumb: at his chosen sport, Formula One motor racing, the man is a genius.

Arguably, he is the finest driver that sport has ever had. Only one, Juan Fangio, in the 1950s, has won the title five times, and Mr Schumacher, backed by the engineers and tacticians of the Ferrari team for which he drives, may have several more years of triumph to come. And though old men like to say that in today's motor racing everything is done by designers, aerodynamicists, engineers, tyremakers, computers and other technology, anything but the driver, he, repeatedly, has proved them wrong. In Formula One every driver cuts corners and (alas) gets away with it: that's why the circuits have those red-and-white striped bits of concrete on the bends where they used to have grass. But Michael Schumacher simply does it, and much else, better.

That's not all he does. Formula One racing, once European, now worldwide, is less boring to watch than the rival American versions: its circuits do actually have corners to go round, not just an eternal oval. But to non-addicts it is still—crashes apart—a non-event, like watching paint dry, and this year's procession of Ferrari victories has made it duller still. Why watch, when you already know the winner? Yet hundreds of millions of televiewers do. Who but Michael Schumacher has won world fame by being even duller than drying paint?

Who but Michael Schumacher has won world fame by being even duller than drying paint?

Or could it be that genius at work is an event in itself? Would you have refused an invitation to the studio of Rembrandt? And think what Mr Schumacher has done for international relations. Majestically brushing past, or into, such British champions as Damon Hill and David Coulthard, he has given that stand-alone nation another ten years or so to carry on sourly fighting the second world war. To Italians, who prefer to like their neighbours, he has given something better: their land, ravaged in the past by Attila the Hun, by the emperor Charles V some 1,100 years later and most recently by Hitler, today has a true German hero. And national pride too: rust may bite into Fiat, their automotive totem, but Fiat-owned Ferrari has never done so well as now.

By the way, or at least on and off the track, Mr Schumacher has also earned gigantic sums of money. As enterprise, risk-taking and hard work should. This paper too salutes him. Though we wish he, and other winners when there are any, would not waste champagne quite so egregiously.

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Letters

Jul 25th 2002
From The Economist print edition

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Present at the creation?

SIR – Your survey of America's world role (June 29th) fails to address the most glaring flaw in a "new world order" spearheaded by the United States; its lack of democratic legitimacy. A globalised economy induces global social dynamics and calls for global political leadership. America is indeed providing such leadership but on the basis of a democratic consensus that represents about 5% of the world's population.

America's refusal to endorse solutions to global problems that may limit its power—from the Kyoto Protocol to the International Criminal Court—is an obvious instance of an unwillingness to subordinate its national interests to a common consensus. An internally democratic oligarchy exerting power over a far larger community is nothing new. But whether South Africa under apartheid provides a viable model for the world's political future remains to be seen.

Italo Vecchi
Ferrara, Italy

SIR – Your survey fails to identify the essence of America's greatness. America is special for reasons more fundamental than its economic and military might. America is what it is because it has the world's best scientists, engineers, movie stars and basketball players—and much of this talent pool remains home-grown, even if immigrants continue to contribute.

If Alexis de Tocqueville visited America now, he would find much undiminished: the remarkable capacity of its people for hard work and ingenuity; the openness of its society and culture; and its apparently unlimited capacity to re-invent itself. America may have some sins in its past but Americans today are the most optimistic, energetic, creative and liberal-minded people of any large nation. While others might seek only the latest bag of capitalist or technological tricks, there is much more humanity can learn from the grand and successful experiment that is the United States of America.

Ramesh Gopalan
Fremont, California

SIR – Your blind reverence for all things American ignores a fatal yet glaringly obvious fault—unbridled hypocrisy. For the four billion people not fortunate enough to live in economic nirvana behind America's protective nuclear shield, it is a self-proclaimed messiah using its unlimited power to destroy and then recreate the world in its image.

America is willing to go to war to prevent an Islamic bomb while actively supporting the development of Jewish weapons of mass destruction. America spends 50-times more to build up its already invincible military than to combat hunger and disease in the world's poorest nations. Preserving the immunity of a handful of Americans against war-crimes charges is more important than preventing a new genocide in the Balkans. While this is the case, America will be seen rightfully as a selfish hypocrite, regardless of the noble principles which it claims to espouse.

Richard Chrenko
San Jose, California

SIR – In a world largely characterised by tyranny, oppression and lack of respect for human rights, I for one sleep easy knowing that the planet's most powerful economic and military machine is in the hands of a peace-loving people who swear by freedom, democracy, free trade and the supremacy of the individual. Despite its flaws and imperfections, America gets my vote for global sheriff any day.

Robert Gentle
Johannesburg

SIR – In times such as these, it is important to consider the role of government: to protect the rights, safety and property of its citizens. All policy matters must be grounded on this premise. Intervention abroad, particularly of the military sort, must be based on a threat to American citizens and not a vague concept of American interests. In this context, the war on terror is justified. A war in Iraq would be justified if there were legitimate fears that its weapons of mass destruction will be used against Americans. Intervention in Somalia, the original Gulf war, foreign-aid programmes and the Bosnian peace-keeping mission are much harder to justify.

It is said that America's might obliges it to exercise power in the name of “good”. In fact, America's overwhelming might carries an obligation not to throw its weight around unnecessarily. America should adopt an open stance on trade and travel; elsewhere let those directly involved sort out their own problems.

William Trent
Trenton, New Jersey

SIR – You claim that America is developing a case for pre-emptive military intervention in Iraq because Saddam Hussein is ostensibly developing weapons of mass destruction. Since when has this ever mattered to America's ruling elites? Or could it be Saddam's brutalities against his own people? The world is full of brutal dictators; many were American clients and some are still. China is busily engaged in a massive military build-up, is developing weapons of mass destruction and has threatened directly a neighbour, Taiwan, with invasion. No American policymaker is proposing pre-emptive strikes against the Chinese. The appalling hypocrisy of American behaviour is that it is chiefly, if not solely, motivated by economic schemes to secure Central Asian oil and gas, not to mention Iraqi reserves at more favourable rates.

Laviero Mancinelli
Daly City, California

SIR – I am surprised and disappointed by your simplistic discussion of a possible American invasion of Iraq. The potential outcomes are terrible. Saddam Hussein will have no deterrence to using his biological and chemical weapons if Iraq is invaded with the sole objective of killing him. If he uses such weapons against American troops or Israeli civilians the response is likely to be the use of weapons of mass destruction against Iraq. What then happens to America's credibility in the world? This could be the shock that might destroy America's leadership in the world. The risk of Saddam using dangerous weapons is much greater if we invade than if we isolate him carefully.

Leonard Goldman
Chapel Hill, North Carolina

SIR – Referring to Saddam Hussein as Saddam is entirely inappropriate. You would not refer to Osama bin Laden as Osama, much less George Bush as George. In doing so, you drop the level of the discourse by several notches. Mr Hussein's policies may be odious but show a little politeness, please.

Jeremy Bernstein
New York

SIR – You say of its world role that America will “have to act alone, as it did in Vietnam”. Australia and New Zealand both sent combat troops to Vietnam; over 46,000 Australians served between 1962 and 1972. An absence of Europeans does not mean that the Americans acted alone.

Antony Kaufman
Sydney

Editor's note: I apologise for this careless error to Australians and New Zealanders, but also to South

Koreans, Thais and Filipinos, who were part of America's coalition forces in Vietnam too.

SIR – Churchill was overly optimistic to say that “You can always rely on America to do the right thing—once it has exhausted the alternatives.” Is not America the country of endless opportunities and possibilities?

Claus Brillowski
Hamburg

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North Korea

Stitch by stitch to a different world

Jul 25th 2002 | PYONGYANG
From The Economist print edition

Something extraordinary seems to be happening in North Korea: the first stirrings of a proper market. Our correspondent finds out what he can

Get article background

ALTHOUGH her wages have gone up 20-fold this month, the woman in the street in Pyongyang, North Korea's capital, is not smiling. “But I will have to pay for housing and rice,” she says. She lives in the “workers' paradise”, where basic necessities were once almost given away. No longer. North Korea, the world's most ideologically rigid communist state, has begun to abandon some of the principles it has long held most dear.

So secretive is this country that official newspapers have yet to mention the massive adjustments of wages and prices that began on July 1st. One office-worker in the capital says the official price of rice has soared from 0.08 won per kilo to between 30 and 35 won. (Officially, the North Korean won is worth 46 cents; on the black market, it is worth less than half a cent.) Another bureaucrat says that housing, once provided for almost nothing, will start costing around 10% of his massively increased salary. Electricity, fuel and transport costs have also risen sharply. A factory manager says diesel is up from one won per kilo to 38 won. Electricity, formerly 0.035 won per kilowatt-hour, is now 60 times more expensive.

The changes could go much deeper. According to one foreign diplomat, factories will no longer get subsidies from the state. They will have to find money for the wage increases and higher input costs from their own budgets. Pyongyang-based diplomats, of course, are allowed to know little of ordinary life in North Korea; they live in a world of rumour and propaganda. But if this particular rumour is so, then few factories will be able to pay their workers anything like the supposed new wages. The basic requirements for making profits—adequate supplies of power, raw materials, parts—are simply not there. The diplomat estimates that North Korean industries are running at 10-15% of capacity.

Embassies in Pyongyang have been urging the North Korean foreign ministry to arrange a briefing on the changes. They have been told there will be one, but by whom and when still remains to be seen. “The Koreans are keeping very quiet about it,” says another envoy.

This report is based on interviews with North Koreans during a week-long visit to the country, which allows only very limited access for foreign journalists. In a country with a long tradition of inventing statistics (in so far as it publishes them at all) and suppressing bad news, the picture is inevitably partial. The extent to which the new price system has been implemented across the country

Acute and chronic food shortages and industrial collapse may at

is extremely difficult to gauge. But it seems that acute and chronic food shortages and industrial collapse are at last forcing North Korean officials to rethink the way they run their economy.

last be forcing North Korean officials to rethink the way they run their economy

At worst, the North Koreans are printing money in a desperate and misguided effort to make citizens feel good. Food is tightly rationed. North Koreans buy their official rice on appointed days, usually once a month, at special distribution centres. A Pyongyang office-worker says the amount she could purchase was the equivalent of around 600 grams per day, or not much more than the daily ration distributed in refugee camps in other starving areas of the world. For most others, the ration has been considerably lower: about 350 grams a day, says the World Food Programme. To supplement these almost-free but meagre handouts, some citizens have been able to buy extra food, at vastly higher prices, from officially authorised “farmers' markets” or from unauthorised peddlers in the side-streets. This month's changes mean the official price of rice is now close to the free-market one, but residents now have, or will soon have, much more cash with which to buy it.

It is not clear what impact the changes are having on free-market prices. Foreigners are not allowed to visit the farmers' markets, presumably because the prices of fruit and vegetables, and whether they were there at all, would hint at the real state of the economy. A foreign diplomat recalls that his unauthorised attempt to inspect one “almost caused a riot”, with officials quickly ushering him away.

By using the farmers' markets as a benchmark for setting grain prices, the government is heading in the right direction. It now appears to believe that grain has a market value, and is not just a commodity which peasants are obliged to grow for little compensation and which urban residents have a right to eat (in small quantities) at virtually no cost. Ten years ago, the state-run Korean Central News Agency proclaimed that “the state supplies the people with food at a cheap price, next to nothing, so that people do not know how much rice costs.” From July 1st, the government can no longer make that claim.

Suddenly, more cash

If rationing continues, prices would be expected to soar in the markets. Ryu Sung Rim, a senior official in the Committee for Cultural Relations with Foreign Countries, says prices in the farmers' markets did indeed rise after the changes were announced, but fell again because of lack of demand. Maybe, but it could be a different story when city-dwellers get their pay packets at the end of this month, their first since the changes took effect.

According to one North Korean official, coal-miners' pay will increase by 30 times (coal is in critically short supply, so boosting miners' morale is essential). Office-workers' salaries (which now average around 100 won a month) will increase by between 17- and 20-fold. An official says Pyongyang residents are being given cash advances to help them cope with the new food prices.

Peasants, who make up about 40% of the population, are also expecting a lot more cash. At the Taekam Co-operative Farm, about 20km north of Pyongyang, senior officials were informed by the government on June 30th that, from the next day, the government would pay 40 times more for the grain it buys from the farm. Ten years ago, wages and the state's procurement price for grain were increased by between 20% and 40%—trifling adjustments compared with what is happening now.

Pak Jae Hong, a vice-chairman of the Taekam co-operative, says the procurement price of pork will rise from 14 won per kilo to 110 won. The price of potatoes (no more than a side-dish in Korean cuisine) would increase a relatively modest fourfold. The result, he says, could be that the amount given to peasants will rise from about 3,000 won a year to 30,000 won, depending on the harvest.

Mr Pak speaks of the changes as if they were no surprise. “Most people in the country had been thinking about the price of rice. It was too low. It was almost free.” The nonchalance with which he proclaims this ideological U-turn is reminiscent of the way officials in neighbouring China began justifying the introduction of market mechanisms in the 1980s.

Farmers' markets seem to have played a role in North Korea's change of tack. They are supposed to be small state-controlled outlets at which farmers can sell produce they grow themselves in the tiny plots of land around their houses. They have been around since the 1950s, but since the mid-1990s they have proved particularly useful in providing undernourished, or near-starving, city dwellers with extra food to supplement their state rations. The demand for extra food is so great that the state can no longer control

prices at these markets. They have become the only part of the economy driven mainly by supply and demand, rather than diktat.

But the huge discrepancy between free- market and state prices of food that emerged in the 1990s reduced incentives for peasants to work hard for the collective. “Some farmers were idle and loafed about. Now [as a result of the price changes] they are enthusiastic about going to the fields, instead of raising chickens to sell eggs in the farmers' market,” says Mr Pak at the Taekam Co-operative. In effect, this is an admission that the mind-numbing agitprop that overwhelms every aspect of North Korean life doesn't really help when it comes to raising production.

North Korean officials do not yet use the word “reform”

But North Korean officials do not yet use the word “reform”. Mr Pak says he does not believe the price of rice will now be allowed to float according to market demand. He also says prices at farmers' markets will not be allowed to rise above those at the urban distribution centres—a notion that foreign diplomats in Pyongyang find implausible, given the government's ineffectual control over the markets in the past few years. Mr Pak describes the new measures as “a tentative policy” which the government will review after a period of implementation and adjust if necessary.

Behind the veil, the details

Quite what this means, like much else concerning the policy shift, is unclear. In a country as tightly controlled as North Korea, grumbling to a foreigner would be extremely risky. Everyone parrots the line of the ruling Korean Workers' Party and speaks of the country's leader, Kim Jong Il, and his late father, Kim Il Sung, the founder of the nation, as if they were divine. Despite the famine of 1996-97, when many died of starvation, there is no sign of open dissent. If anyone in North Korea is troubled by the implications of the recent changes, they certainly would not say so to a foreign journalist.

Shops in Pyongyang remain, as usual, almost empty of merchandise and customers, except for those using foreign currency or the special won notes that are given in exchange for it. There is no sign of panic buying or a rush to the banks (not that most North Koreans have money to save, and those that do would probably prefer to keep their money at home in dollars). If inflation were to strike the farmers' markets and the peddlers' stalls, this would probably make little difference to urban residents long used to being able to afford only the most basic necessities. The impact on pensioners is unclear, but there are few unemployed (the government says none), even though many have little or no work to do in their decaying factories.

One big question is how the state would respond if farmers' market prices rise. If it intends to adjust grain prices frequently, based on the price grain fetches in the markets, then some city folk could find it increasingly difficult to buy rice at affordable prices. Mr Ryu, of the Committee for Cultural Relations, admits that “there may be some shortcomings when we carry out the new measures,” but adds, “I can say with conviction that as a result of these measures we expect production to improve greatly in our country.”

Corn first, capitalism next?

Yet although these changes may have removed some psychological barriers to economic reform, reform itself is not inevitable. Officials have given no hint that they would like to encourage private business or give individual farmers bigger plots of land on which to grow crops for profit—measures that have had a considerable impact on China's once-similar economy. Industry cannot recover without massive investment, which could come only from abroad. But thanks to its confrontation with the United States, North Korea is denied membership of international financial institutions, such as the World Bank, that might help it rebuild its infrastructure. World Bank membership would also require a far greater degree of economic transparency than North Korea appears willing to offer.

The struggles of an outcast

Mr Ryu points proudly to the recent changes as evidence that North Korea is striving to improve its

economy by its own efforts. Foreign aid to North Korea, therefore, is not the same as “pouring water into a bottomless pot”. But even if the new measures do help to stimulate production, this will long remain a country dependent on handouts. As a foreign diplomat puts it, “It is not a developing country. It is going downhill.” The country has recovered somewhat from the famine of the 1990s, thanks mainly to massive food aid. But the World Food Programme (WFP) is still appealing for as much food aid for North Korea as it is for Afghanistan.

North Korea is very dependent on handouts. But keeping foreign aid flowing is increasingly difficult

Keeping the aid flowing in is proving increasingly difficult. Japan has offered nothing to the WFP this year, because of its political disputes with North Korea. South Korean bilateral food aid to the north (delivered directly rather than through the WFP) is also on hold because of heightened tensions. David Morton, the WFP's representative in Pyongyang, says he expects his agency to run out of cereals to distribute to the million or so recipients of WFP aid in North Korea—pregnant women, nursing mothers and pre-school children. In May, the aid shortfall forced the WFP to suspend handouts to the elderly and secondary-school pupils. “I see secondary-school children all filing out with their teachers to the hillsides, picking wild foods, which the Koreans have traditionally done, but now they're having to rely on those wild foods much more,” says Mr Morton.

North Korea does itself few favours by concealing this widespread hunger (which is worst in the cities) from foreign journalists. But even at the Taekam Co-operative Farm, a model institution which receives trucks and other aid from the Chinese government, some of the difficulties are clear. “You may think it is a nice situation,” says Li Jong Jik, the farm's chief engineer, as he surveys a field of green paddy. “But actually it is not so good.” He points to yellowing leaves at the base of the stalks, and says the plants should be twice as tall at this time of year.

The problem is a lack of fertiliser. Since the collapse of the Soviet Union and, with it, the end of Soviet oil supplies to North Korea, the country has been able to produce only a small proportion of its fertiliser needs. Mr Li says the farm receives less than half of the fertiliser it once used. It produced 5.2 tonnes of rice per hectare last year, compared with 8 tonnes in 1989. It is hoping for 6 tonnes this year, but a lot will depend on the weather. North Korea has little arable land, and frequent floods and droughts.

Hope in ostriches

Even if farm production were to achieve its maximum potential, the WFP's Mr Morton says North Korea would still not be self-sufficient in food. Dependence on aid will cease only when the country's industry recovers to the extent that North Korea can afford to buy grain from abroad. North Korea says it wants foreign investment in everything from mining (there are plenty of rich resources to mine) to textile production. Yet, so far, foreign investment is negligible. “They need to build up trust. They need laws, regulations—but mainly trust. And that's a long way off,” says a foreign diplomat.

This leaves North Korea scrabbling, sometimes in bizarre ways, for foreign currency. One of Kim Jong Il's pet projects is an ostrich farm set up about two years ago halfway between Pyongyang and the city's airport. The investment for this huge facility came from pro-Pyongyang Koreans in Japan—who account for a high proportion of North Korea's hard-currency holdings, but have less to give as Japan's economy founders. The manager boasts that Mr Kim has given instructions on how to raise ostriches on some 40 occasions. He says a Swiss firm is interested in buying the meat and believes the Chinese would like to buy the leather. But apart from some ostrich products on sale in hard-currency shops in Pyongyang, there is little sign that North Korea's ostrich industry is pulling in the money.

Kim Jong Il's favourite project

North Korea had also hoped to raise some hard currency by attracting foreign tourists to a display of synchronised dancing and gymnastics by some 100,000 performers and schoolchildren. They would hold up flip-cards to display vast images ranging from ostriches to armaments. This event was supposed to run from April to June, but has been extended, since the world has not rushed to come. The main hotels in Pyongyang (even the one with that big attraction, a casino for foreigners only) appear mostly empty.

Foreign diplomats wonder whether North Korea's plans to revive its economy by juggling with prices and wages are any more realistic. “They're trying to do something, but they've not got a grasp on what,” says one. Mr Ryu, of course, is more upbeat. He says the government has formed a big team to monitor the price and wage increases. “I think those experts have gathered information (about price adjustments) not only from within this country but also from abroad, including China,” he says, in a rare hint North Korea might be learning from the economic reforms carried out by its neighbour. Then he offers some old-style advice: “You can write that it will have a very positive impact.”

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George Bush

The disappearing presidency

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From The Economist print edition

AP

The markets have fallen by $2 trillion in July. On their way down, they have wiped much of the post-September 11th sheen from the Bush presidency

WHEN George Bush was sworn in on January 20th 2001, the Dow Jones Industrial Average stood at 10,600. This Monday, the Dow fell below 8,000. That is the same 24% fall that Herbert Hoover suffered in his first 18 months in office, which included the 1929 Wall Street crash. Judged by the broader Standard & Poor's index of 500 stocks, Mr Bush's first year-and-a-half has been the worst ever recorded.

At the start of this year, Mr Bush was the most popular president in living memory. Two in three Americans thought their country was on the right track. There had been a huge spike in people's trust in government and other public institutions. The Dow was over 10,000. And the Republicans seemed likely to retain control of the House of Representatives in November, and even to win back the Senate.

Now, trust in government has collapsed. Fewer than half the people think the country is on the right track. Mr Bush's popularity is falling. With the mid-term elections just over three months away, Democrats think they can retain the Senate and grab the House (see article). Some Republicans are starting to worry that if the economy slips back into recession next year, Mr Bush could even lose his re-election contest in 2004.

Is it really that bad? The answer is not yet. For the moment, the Bush presidency has not been too badly affected by the markets. But look a little bit forward and most of the roads seem to be leading downhill.

Mr Bush's list of current strengths begins with the fact that the economy, statistically, is still in reasonable health. Glenn Hubbard, the head of the Council of Economic Advisers, has said the fall in the markets will not “overwhelm the upward path of the recovery”. For most Americans, the important influences on spending are a job and a salary, not their stock portfolio. Unemployment is low; incomes are up.

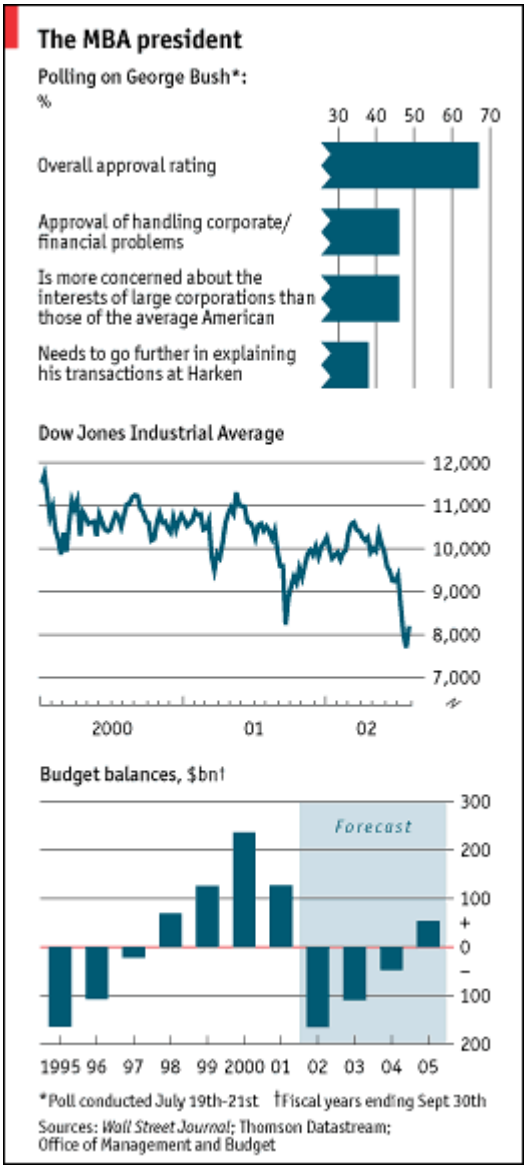
Moreover, devastating though the fall in the Dow has been for investors, there is a case for saying the market was overvalued; it needed to fall; and the best thing was to get the decline over

with without too much damage. On this view, the current transitional decline is a dangerous moment—but there is plenty of economic stimulus in the pipeline and, once the moment has passed, the markets and the country can return to normal.

The Republican political position is not bad, either. The biggest worry is not the president's decline in popularity—that was never likely to be sustained—but the increase in the number of people saying the country is on the wrong track. More than half now say this—a level of anxiety as bad as that on September 10th. Still, Matthew Dowd, an adviser to the Republican National Committee, takes heart in other more positive indicators. In early September, when Mr Bush's approval rating was 50%, almost as many people disapproved of his handling of the economy as approved of it and Democrats had a four-point polling advantage over Republicans. Now, Mr Bush's personal approval is still over 60%; his approval on the economy is above 50%; and Democrats and Republicans are more or less even.

Lastly, it is worth remembering two imponderables. The chances are that the Bush administration will invade Iraq sometime in the next 12 months. It is possible al-Qaeda will launch another strike against America in that time. Either event would dramatically affect American politics, at the very least by moving the focus of attention away from the market to what many regard as the real issue for the administration—national security.

All those are reasons for thinking the current woes might blow over. But they include a lot of “ifs” and “maybes”. And set against this account is the harder fact that Mr Bush's predicament does not look good, and is likely to get worse. The administration's incompetence at handling the meltdown is itself becoming a problem, first because it is doing nothing to calm investors' nerves, and second because it is undermining Mr Bush's reputation—such as it is—as a domestic-policy maker.



For a start, there appears to be no one in charge of economic policy. Traditionally, the treasury secretary is an administration's spokesman in dark moments. Robert Rubin played that role for Bill Clinton, famously standing on the steps of the Treasury to read a market-calming statement during the turbulence of October 1997.

Paul O'Neill, the current treasury secretary, is known more for his gaffes than his gravitas. After a string of ill-advised off-the-cuff comments over the past 18 months, Mr O'Neill has come to be regarded by Wall Street as a figure of fun. Recent events confirmed that view. Mr O'Neill was in Kirgizstan when the market was tanking. Questioned about the wisdom of such a trip, he expressed amazement “that anybody cares what I do”. Increasingly, they don't.

Unfortunately, the White House appears incapable of filling the vacuum. As Robert Hormats of Goldman Sachs points out, America needs an economic equivalent of the defence secretary, Donald Rumsfeld, who confidently explained American policy on a daily basis in the months after September 11th. Mr Cheney might have filled that role, but he cannot appear in public without being inundated with questions about Halliburton, the company he headed which is now being investigated by the SEC. The White House did not have a single economic spokesman on last Sunday's talk shows, which help set Washington's agenda.

Things are so bad that senior Republicans argue openly that a shake-up is needed. The smart money reckons that Mr O'Neill will be replaced after the November elections. A few even speculate about an earlier change if the markets fall further. But Mr Bush went out of his way to praise his embattled treasury secretary this week, saying he had “all the confidence in the world in him”. And there is no obvious successor. With the spotlight shining so harshly on corporate America, it is hard to imagine another businessman in the cabinet. Mr Bush is famously ambivalent about Wall Street types, who may anyway be tainted by the widening scandals.

Things are so bad that senior Republicans argue openly that a shake-up at the treasury department is needed

That leaves Mr Bush himself as the only person to make big public statements about the markets—disastrously. After two badly-received speeches on corporate reform and the economy, Mr Bush this week also moved on to make off-the-cuff comments. Though the president admitted “I'm not a stockbroker or stock picker”, he claimed investors should see “value” in the market at its current level.

This impromptu approach leaves the White House looking like it has no control over the policy response—which in some ways it doesn't. The legislation on corporate reform is a case in point.

In his Wall Street speech, Mr Bush cast the loss of confidence as a case of a few bad apples, and eschewed dramatic systemic reform. Yet on July 24th, Congress passed a far-reaching corporate-reform law based on a bill sponsored by Paul Sarbanes, a Democratic senator (see article). Mr Bush now says he will sign it. But it is not what he originally wanted, nor even the result of a process he had any influence on. That might well be good in this case, but in the run-up to the November elections, it poses a risk. If market turmoil continues, the desire of lawmakers (especially Democrats) to look tough could push regulatory reform too far. With little economic leadership from a weak White House, that risk rises substantially.

Drifting down the river

Of course, there is not much any politician could do in the very short run that would be sure to restore investors' confidence in the markets or the integrity of corporate America. The trick is to look as if you know what you are doing—and Mr Bush's shortcomings in this respect may be doing damage to his presidency.

The problem for Mr Bush starts with those “right track/wrong track” numbers—often called the Dow Jones of politics because they catch the changing national mood. Karlyn Bowman, a poll-watcher at the American Enterprise Institute, points out that this indicator is more sensitive to deep-rooted social and moral trends than to political mood-swings. Its decline now has more to do with things like the crisis in the Catholic church and worries about progress in the war on terrorism, than passing political embarrassments, like Mr Bush's speech. For that reason, it is also hard to change quickly. The drop in the “right direction” numbers has been precipitous: some polls put the decline at 15 points in just three months.

More conventional political indicators tend to follow the “right direction” numbers with a lag. Charlie Cook, a political analyst, argues that this is a four-stage process. First comes the drop in the “right track” number. Then, presidential job ratings follow a couple of months later. That happened with George Bush senior in 1991 and is starting again: George Bush junior's approval ratings have fallen two points a month since January. This may have always been going to happen, but the decline is relentless.

Mr Bush is still seen as a terrific commander-in-chief, and not just your run-of-the-mill politician. The public has not found him guilty by association with the business scandals, and is so far indifferent to stories about his own corporate record. But doubts have existed from the start about his policy-making competence. His administration's bumbling is exacerbating those doubts just at the time when economic jitters are putting a greater premium on domestic-policy skills. Voters may not be turning against the president, but they seem to be reserving a judgment that had previously been favourable.

That leads to Mr Cook's third stage: after falls in the “right direction” and presidential numbers, party ratings start to change. So far this year, neither party has been able to establish any advantage in the polls. But in the past few weeks it is just possible that this too may be starting to change. Democrats have begun to open up a small but consistent lead. And that could forecast a big problem for the Republicans, since the fourth stage of Mr Cook's process is the dénouement, polling day.

It is still too early to predict the mid-term elections with much confidence, though the balance has swung towards the Democrats. It is even more dangerous to guess at how the loss of the House, if it happens, would affect Mr Bush. But what is clear is that the market turmoil has returned politics to something rather like the status quo before September 11th.

That suggests the extent of Mr Bush's lost opportunity: he failed to use the past ten months to create any sort of transforming bipartisanship on domestic policy. His presidency now rests on his reputation for personal integrity and, in a way worryingly reminiscent of his father, on foreign-policy achievements that may count for little come November.

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California v Detroit

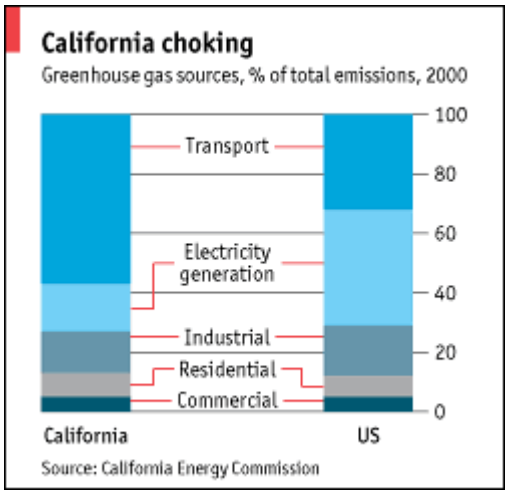
Green Davis

Jul 25th 2002 | SAN FRANCISCO
From The Economist print edition

California wants car makers to cut greenhouse-gas emissions

THANKS to Los Angeles's long history of filthy air, California is the only state that is allowed to set its own pollution standards. In the past it has used this right to make car manufacturers cut down the exhaust emissions that cause smog. On July 22nd Gray Davis, the governor of California, signed a law that extends the principle to greenhouse gases. The California Air Resources Board (CARB) is instructed to set standards for the emission of carbon dioxide and other such gases from private cars and lorries. This is a first in America.

On its own, even mighty California cannot make much of a dent on the greenhouse effect. Transport produces 57% of California's greenhouse gases, which are 6% of the American total, which is about 25% of the global total; so, however stiff the standards, the direct impact could be well under 1%. But because it is such a large market—Californians bought 2.1m new vehicles last year, 10% of the total in America—California's standards influence the design of cars across the country. Jubilant environmentalists hope the new law will divert Americans away from "sports-utility vehicles" towards more efficient cars. Car makers and oil producers are afraid that the environmentalists may be right.



Mr Davis was eager to place the law, and himself, squarely in California's tradition of setting the pace on such things, from safety belts to unleaded fuel. California was leading the way because, he said, "Washington politicians have failed to act." For good measure, he signed the bill twice—in Los Angeles as well as in San Francisco—with plenty of photogenic supporters from stage, screen and elsewhere, such as Robert Redford, on hand.

The bill, which cites the threats posed to California by global warming—from coastal floods to mountain droughts—strengthens Mr Davis's green credentials just when he is seeking re-election. On the face of it he does not need that much help: his inexperienced Republican opponent, Bill Simon, lies to the right of most Californian voters and seems to be making a hash of his campaign (he tried to put an end to one fiasco by revealing his tax records this week). But Mr Davis needs to guard his left flank. A scandal earlier this year concerning state contracts for software from Oracle, one of his campaign contributors, convinced some liberals that he was too fond of big business. The new bill may limit the drift of voters to the Greens.

Beyond good intentions, however, the bill is vague. It leaves all details of the new standards to be decided by CARB, requiring them simply to produce the "maximum feasible reduction" of greenhouse gases. The board must produce its rules by 2005, for review by the state government, before they go into effect for cars sold in 2009. That leaves Mr Davis free to fight for re-election; he may even have a shot at the White House long before anyone pays for a car designed to the new standards.

At least it is clear what will not happen. After the car industry ran advertisements in the spring saying that the state was preparing to ban sports-utility vehicles, the bill's author in the Assembly, Fran Pavely, a Democrat whose district encompasses Malibu and its dreamy beachfront neighbours on the western edge of Los Angeles, added a list of all the things it would not do. They include bans on specific types of vehicles, new petrol taxes or fees for driving and lower speed limits.

Opponents of the bill still complain that it will raise the price of all vehicles and so push popular designs out of range of poorer Californians. The cleanest cars sold in America today—hybrids that link an electric motor to a conventional petrol engine—cost more than equivalent models that use only internal combustion.

So far, Californians seem untroubled; one opinion poll has said that 81% of them support the law. Car makers have given up the idea of appealing for a referendum, and are concentrating on a legal challenge.

The Alliance of Automobile Manufacturers says CARB has no right to set standards for greenhouse gases such as carbon dioxide, which is non-toxic and not a conventional pollutant. And, since carbon-dioxide output is proportional to the amount of petrol used, California is in effect setting fuel-economy standards, says the alliance, not pollution standards. That is the job of the federal government—and the Senate earlier this year voted not to raise them. California reckons it can win that fight. It is betting that the industry will come to love greenery as much as the safety rules it once hated.

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America and the United Nations

UN-nerving

Jul 25th 2002 | NEW YORK
From The Economist print edition

Now, battles on abortion and torture

ANOTHER week, another row about multilateralism, with America claiming its right to dissent on a matter of principle and much of the rest of the world claiming that George Bush is trying to destroy international agreements from which the United States has already won partial exemption. Barely had the fuss about the International Criminal Court died down when two new controversies emerged: the first to do with the United Nations and family planning, the second to do with preventing torture.

On July 22nd the State Department said it would withhold America's $34m contribution from the UN's Family and Population Fund (known as UNFPA), which supports family-planning and reproductive-health programmes in 142 countries. Congress approved the money last year, but it had been under review. The $34m will now go to the State Department's Agency for International Development.

The administration has backed some anti-abortion Republicans who claim that the population fund indirectly supports forced abortion and sterilisation in China. (Congress long ago passed a law banning the use of American money for such purposes.) Nonsense, replies the UNFPA: it does not support abortion, in China or anywhere else. In May, a State Department visit to China found no reason to think otherwise and recommended giving the money. Besides, America has long had a concession, mandating that none of the money it gave the population fund could be spent on programmes in China.

The decision has naturally annoyed the same abortion-rights people who were furious when Mr Bush suspended the “Mexico city” gag rule, preventing American money from going to organisations that supported abortion. But even people who saw that action as part of the routine tit-for-tat of American abortion politics are annoyed by the UNFPA decision, because Mr Bush has ignored the evidence from the UN and his own people on the ground—and hurt family planning, not abortion.

Only a year ago, when he was petitioning Congress for more money for the agency, Colin Powell, the secretary of state, wrote that the UNFPA “does invaluable work through its programmes in maternal and child health care, voluntary family planning, screening for reproductive-tract cancers, breast-feeding promotion and HIV/AIDS prevention.” According to Thoraya Obaid, the UN agency's executive director, the American contribution could have prevented 2m unwanted pregnancies, nearly 800,000 induced abortions and more than 77,000 deaths.

The Democrats may also be able to make something out of the torture debate—not least because America has sided against its allies and with such champions of human rights as Cuba and Iran. Earlier this year, after a decade of negotiations, an optional protocol to the 1984 convention against torture was approved by the UN's human-rights commission. Under the protocol, international and national observers would pay regular visits to prisons in countries that sign up.

On July 24th America, which has been a member of the convention against torture since 1994, tried to send the protocol back to the drafters. It says the mandatory inspections are too intrusive, and also claims that it would be difficult to operate in federal countries, where prisons are managed at local level. Imagine foreign bureaucrats showing up unannounced at Guantanamo Bay.

Not true, reply the protocol's supporters, who won this week's vote comfortably and expect the General Assembly to approve it in September. The observers have to work out a schedule with local authorities (and the worst that they can do is to name and shame anybody who says no). The protocol is aimed primarily at governments in poor countries, which want to use international observers to insist on better behaviour in local prisons. If America does not like the protocol, it can simply not sign it. But, after ten years, why wait?

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Tennessee in trouble

A state full of chickens

Jul 25th 2002 | NASHVILLE
From The Economist print edition

A shambolic budget, confused Republicans—and Al Gore

AP

A hit tune in Nashville

TENNESSEE'S primaries do not lack for southern colour. The leading Republican candidate for governor, Van Hilleary, is sponsoring a racing car. One of his opponents has sent actors dressed as giant chickens to mock Mr Hilleary for not debating. Another, a Methodist minister, says God told him to run (a good qualification in a state whose constitution bans atheists from office).

Yet the primaries on August 1st deserve to be taken seriously. Tennessee has by some measures the biggest budget mess in the country. Thanks to redistricting and retirements, three House seats, a Senate seat and the governorship are all up for grabs.

The voters of Tennessee are a conservative lot. Even if they like their local Democrat—both houses of the state legislature are Democrat-controlled—they often vote Republican for higher office. The Republican governor, Don Sundquist, won his second term by a landslide in 1998.

Mr Sundquist is not allowed to run again; anyway, his popularity has dropped as the state's cash crisis has mounted. In 2001 the people of Tennessee paid less tax per head than the citizens of any other state except South Dakota. A state income tax is outlawed in Tennessee's constitution: its money comes from sales taxes and business taxes. Like many other states, Tennessee spent far more during the 1990s than it received. TennCare, the state-run alternative to Medicaid, set up in 1994, alone eats up a fifth of Tennessee's annual budget of $9.6 billion.

A month ago, politicians found they had to plug a hole of nearly $1 billion. Mr Sundquist favoured introducing a state income tax; the legislature did not. When a July 1st deadline slipped by, the governor sent half the state's workforce home. On July 3rd a compromise squeaked through that raised the sales-tax rate from 6% to 7%. Once you add in the levies from counties and cities, the average is more than 9%—arguably America's highest. In theory, some new money could come from a state lottery, which is on the ballot in November.

More generally, there is wrath about what Standard & Poor's, a rating agency, has called the state's “ongoing political inertia”. As John Geer, a professor of political science at Vanderbilt University in Nashville, points out, that inertia is intrinsic to the system: the state legislature can override the governor's veto with a simple majority. All the same, the hapless Mr Sundquist is under fire from all sides, not least from Nashville's powerful conservative radio shows.

The leading gubernatorial candidates are scrambling to distance themselves from the income tax, while carefully avoiding the job of producing alternatives. Mr Hilleary talks vaguely about making TennCare less generous. Jim Henry, a state legislator, wants a constitutional convention to discuss tax alternatives. The leading Democrat, Phil Bredesen, has also dismissed the income tax. The one person who favours it looks out of the running.

The budget mess has also popped up in the congressional races. Three current congressmen, one Democrat and two Republicans (Mr Hilleary being one), are leaving their seats to pursue other offices. Since district lines have recently been redrawn, the parties are not guaranteed to keep those seats. Among the Republicans squabbling over the western 7th district, the narrow leader, a state senator, Marsha Blackburn, made her name by opposing the income tax; her opponents are vying to be more

anti-tax than she is.

The Republican Senate seat, given up by the retiring Fred Thompson, does not look safe either. At the moment, the opinion polls show Lamar Alexander, a former governor and two-time presidential candidate, beating Ed Bryant, a conservative congressman, in the Republican primary. Mr Alexander also leads Bob Clement, the Democratic candidate; Mr Bryant does not. But he may be on the rise.

Tennessee's elections may also have implications for Al Gore, the state's not-quite-favourite son, who was in Nashville for July 4th. Mr Gore lost the state to George Bush in 2000. Might a strong Democratic showing this year stoke his ambitions for 2004?

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Jim Traficant

Hair today, gone tomorrow

Jul 25th 2002 | WASHINGTON, DC
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The Klingons got Jim in the end

AP

Going to a better place

CONSIDER a recent exchange between James Traficant, a Democratic congressman from Youngstown, Ohio, and a woman called Sandra Ferrante. The occasion was the sombre meeting of the Committee on Standards of Official Conduct. The subject was whether Mr Traficant should be expelled from Congress. Ms Ferrante was a rare friendly witness:

Traficant: *Were you and I sex partners?*
Ferrante: *No*
Traficant: *Why not?*

Today's politicians are a tedious lot: identical blue suits, identical blow-dried hair, same platitudes about freedom and responsibility. Republican or Democrat, Yankee or southerner, product of the inner-city or the outer-suburb, all have been put through the same finishing school.

Mr Traficant bunked that part of his education. His hair looks like a strange grey animal. He usually eschews suits (unless they are made of denim) in favour of bell-bottoms and double-knit jackets. His utterings are alternately surreal and profane. He once claimed on TV that Janet Reno was a lesbian drunk who had dallied with call girls (the then attorney-general denied this). He likes to end his interventions in Congress, which are usually directed against the evils of foreign aid, free trade, the Federal Reserve and the IRS, with a line from “Star Trek”: “Beam me up”.

Our hero has, however, had an adversarial relationship with America's legal system. In 1983, when he was a local sheriff in Ohio, he was put on trial for receiving Mafia bribes. The prosecution had him on audio tape admitting that he had received more than $100,000 from the Mob. But Mr Traficant, who mounted his own defence and referred to himself throughout as “my client”, persuaded the jury that he was conducting a one-man sting operation.

Mr Traficant becomes only the second congressman to have been expelled since the Civil War

Mr Traficant then used his triumph to launch his career in national politics, winning a seat in 1984. “I figured I would offer fashion, cerebral intelligence at a magnificent level and the ability to communicate for my district,” he claimed. But on April 11th his most recent case, in which he argued with the judge and threatened the prosecutors, ended badly. He was convicted of several crimes, including doing favours for bribes and requiring congressional aides to work on his farm. His sentencing is set for July 30th, and federal prosecutors want at least seven years.

Before the standards committee, Mr Traficant refused to change his defence. He referred proudly to his home district as “Mobtown, USA”, repeatedly insulted the committee members (“You, you Coors-drinker”, he spat at the chairman, a Colorado Republican) and explained that he bought a boat because “I wanted to have *Playboy* bunnies come in and meet with me at nights, and I wanted to be promiscuous.” The committee unanimously recommended his expulsion. And on July 24th the House voted 420-1 to boot him out (the noble hold-out: Gary Condit). He becomes only the second congressman to have been expelled since the Civil War. He and his hair will be much missed.

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The romance novel

True love returns

Jul 25th 2002 | DENVER
From The Economist print edition

America rediscovers its heartland

FOR a few days in mid-July, there really was a place where women who “smelled of wildflowers and smoke” and had “a long tumble of flaming curls around a face of rose and cream” could glance hopefully at men with “eyes of clear and calm blue that could harden to steel”. It was Denver, Colorado, where life recaptured something of its old innocence at the annual conference of the Romance Writers of America. This is a body founded in 1980 by three dozen authors who, oppressed by the gritty greyness of the realist school of novel-writing, set out determinedly to recreate the world of P.G. Wodehouse's “Honeysuckle Cottage”.

How well they have succeeded—up to a point. The Romance Writers today have more than 8,000 members. More than 1,500 people turned up at this year's assembly. Sales of romantic books—now a third of all the fiction sold in America—topped $1.5 billion last year, and the figure is rising.

There is, of course, a price. These days the bestseller lists are studded with titles such as “One Night of Passion”, “Fast Women” and “Sins of Summer”. The definition of romance has evolved along with the expectations of the (almost entirely female) readership of these books. So have their covers. A picture of a muscled hunk embracing a knee-buckling waif is embarrassing to hold up to other people's gaze in an airliner or your firm's office. Covers nowadays are more likely to be a swirl of pastel colours around a burst of flowers. The lust advertised by those titles is for the reader's eye only.

Characters have changed too. The typical hero is no longer a brooding English aristocrat with a large estate who, on a chance visit to a sick aunt, meets a lovely, lonely, virginal 17-year-old, says Charis Calhoon of the Romance Writers. “Cops, firemen and blue-collar workers are incredibly hot.” Women have aged a decade or two, even three; not a few of them are curvaceous moguls. There may even be a divorcee with a child.

Some traditions endure. There has to be a relationship. Generally, the heroine and the hero remain monogamous after they meet, regardless of whether it is in Chapter Three or Chapter Ten, however chequered their past, and no matter whether they hate each other at first sight. And there has to be a happy ending. “The conflict,” says Ms Calhoon, “is the struggle to make your love work,” which means, she adds, the struggle to maintain “commitment, monogamy and”—well, there has to be some concession—“a sense of fashion.”

The reigning queen of this world is Nora Roberts, author of such classics as “Tears of the Moon”, “Jewels of the Sun”, “Born in Fire”, “Born in Ice” and “Born in Shame”. She has written 145 books under her own name, almost all of them following the same pattern: a flawed couple meet, have explicit sex (“hot blood and violent lust he knew he could only chain down for so long”), painfully break up (“Love, she thought, could be such a lie”), and then reunite.

Recently, in her spare time, Ms Roberts has begun writing books under the name of J.D. Robb (“Reunion in Death”, “Betrayal in Death”, “Purity in Death”) in which the chief theme is a mystery, not love (though love is not left out). This year she has published two mysteries, three romances and four reprints. As fast as she produces them, readers inhale them. Every minute another 34 are sold. At the Denver conference the queue waiting for her autograph extended the length of a vast ballroom. When she put her pen down, there was not a copy left to sign. Unsated admirers were left panting for more. And more.

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Lexington

Beware the Gepper

Jul 25th 2002
From The Economist print edition

Richard Gephardt is going from strength to strength. Alas

RICHARD GEPHARDT has spent his political career failing to reach the top of the greasy pole. The Missouri Democrat made his first run for the presidency in 1988 but lost the nomination to Michael Dukakis, who had more money. He decided not to run in 1992, only to see an unknown governor from Arkansas thrash the "unbeatable" George Bush senior. He failed to lead his party to retake control of the House of Representatives in 2000 by a mere five seats, or a few thousand votes.

But it looks as if luck is finally on Mr Gephardt's side. A storm of corporate scandals and the plunging stockmarket could put him in the Speaker's chair in November. George Bush's political capital is sinking even faster than the average equity portfolio. The congressional Republicans are heading for the shore. With the wind behind them, the Democrats are now expected to win the handful of seats they need to take control of the House. If the voters are really angry with Mr Bush, they might do even better, though gerrymandering and the power of incumbency mean that only about 10-15 seats look up for grabs.

What is Mr Gephardt going to do if and when he finally reaches the top of the greasy pole of House politics? Lesser men might simply sit there and enjoy the view. The speakership is the third-highest job in American politics, and Mr Gephardt has been serving his apprenticeship for 13 gruelling years. Yet almost everybody in Washington expects him to give up the speakership fairly quickly (or even to turn it down) in order to concentrate on running for the presidency.

There is no shortage of evidence of Mr Gephardt's presidential ambitions. He has made a series of "big think" speeches that are designed both to burnish his moderate credentials and to prove that he is more than just a political mechanic. He recently declared his unequivocal support for military action against Iraq, a move that may have undone the political damage caused by his decision to vote against the Gulf war. He has adopted the hyperactive schedule of a presidential candidate.

Mr Gephardt has been on the wrong side of every economic debate for the past two decades

Is Mr Gephardt a plausible candidate for the party's nomination? He undoubtedly has valuable assets: a wealth of experience, the goodwill of the House Democrats, and a remarkably youthful appearance. He has a reputation for being able to work with his party's warring factions. He recently accepted an invitation to speak to the Democratic Leadership Council (DLC), the moderate Clintonian organisation that he helped to found and later fell out with, but took John Sweeney, a top trade unionist, along as his guest. He is also likely to get off to a good start in the early primaries: he won the Iowa caucus back in 1988, when he was a much less substantial figure than he is today, and he has the money and trade-union backing to build on his momentum.

Yet it is hard to escape the impression that Mr Gephardt is less than the sum of his parts. He is a chameleon: a man who started his political life as an opponent of abortion, busing and a minimum-wage hike but who is now a stalwart of his party's left wing. He is also a man who tends to shrink in the glare of publicity. His speeches become dull and mechanical, his arguments as insubstantial as his eyebrows. A recent poll found that only 5% of Democrats would vote for Mr Gephardt in a primary election compared with the 46% who said they would vote for his fellow shape-shifter, Al Gore.

The fact that Mr Gephardt has a hill to climb to win his party's nomination will not prevent him from doing political damage. For all his emollient appearance, Mr Gephardt represents his party's most atavistic wing. And he is a substantial enough figure to force his rivals to run to the left in order to thwart him. The problem is not so much that Mr Gephardt is a populist. Populism is almost *de rigueur* in the Democratic Party these days—and Mr Gephardt can at least claim that he has been banging that particular drum for a decade now. The problem is that he mixes heartfelt populism with heartfelt protectionism.

Workers of the world unite—and stop him

Mr Gephardt has always been an outspoken opponent of free trade: a man who has fashioned a gut hostility to trade into a coherent political ideology. He has a mid-western sense that it is quite enough to trade with distant places like New York and Los Angeles without bothering with the rest of the world. (His constituency, in suburban St Louis, is demographically, if not geographically, close to the middle of the country.) He has buttressed this instinctive economic isolationism by soaking up anti-trade literature and travelling widely around the Mexican-American border. If Mr Bush is a wholly-owned subsidiary of big business, as Democrats like to argue, Mr Gephardt is a wholly-owned subsidiary of big labour.

He split with the DLC over its support for free trade. He ran a fiercely protectionist presidential campaign in 1988, and took on the Clinton White House over NAFTA in 1993. He is now leading the opposition to George Bush's Trade Promotion Authority. Rather than softening his line on trade—or apologising for talking such nonsense about NAFTA—Mr Gephardt claims that public opinion is moving his way.

Anybody who admires human endurance must be impressed by Mr Gephardt's determination to shimmy to the top of the congressional pole—and by his willingness to contemplate, at his moment of triumph, jumping from one pole to another. But anybody worried about the state of the world's economy will wish him the worst of luck. Mr Gephardt has been on the wrong side of every economic debate for the past two decades, from his insistence that Japan would take over the world economy in the 1980s to his scaremongering about NAFTA in the 1990s and his insistence that the United States should dictate labour standards to poor countries today. The last thing the world needs now is for more power to go to one of America's most convinced and articulate protectionists.

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Politics in Venezuela

Weathering the storm

Jul 25th 2002 | CARACAS
From The Economist print edition

Getty images

Hugo Chavez and his government are hanging on. Just

Get article background

VENEZUELA'S embattled President Hugo Chavez, who is much given to colourful similes, recently compared his “revolutionary” government to a ship that has just come through a storm. “Now that we are sure we're not going to sink,” he said, “we are once again looking for the horizon.” The storm in question was April's bungled coup attempt, along with the political turbulence that followed. Having ridden out the succeeding weeks, including a sensitively handled annual round of military promotions, the president may be forgiven a smile of satisfaction. Yet his ship is still in dangerous waters.

Since the failed coup, Venezuela has become even more polarised. Earlier this month, the opposition organised a mass anti-government demonstration and spurned mediation attempts by Jimmy Carter, a former American president. Mr Chavez is liked by the poor, but many other Venezuelans believe that his authoritarian populism and his “Bolivarian revolution” are leading their country to ruin. Though he is democratically elected, and despite having failed to overthrow him by force, the opposition is still determined to get rid of the president by any possible means before the next election, scheduled for 2006.

Mr Chavez is liked by the poor, but other Venezuelans believe that his authoritarian populism and “Bolivarian revolution” are leading to ruin

Luis Miquilena, a former interior minister and once Mr Chavez's key political operator, has been trying to overthrow him by means of non-violent, “constitutional” methods. The opposition is pushing for a referendum on the presidency, though this will have to wait until August 2003. In the meantime, Mr Miquilena is trying to have the president impeached for any one of a couple of dozen alleged crimes. He has been calling in favours from supreme-court judges and congressional deputies. And he is said to have asked would-be coupsters for time to put his plan into effect. A second coup, which several sources say was planned for the early hours of June 25th, did not take place. A self-confessed conspirator (who, not unnaturally, requests anonymity) says that a plan to overthrow the president was postponed at the request of a group of civilians led by Mr Miquilena.

Coup-mongers may not consent to stay their hand indefinitely. They have been watching Mr Miquilena's attempts—so far largely fruitless—with scepticism. Their military leadership appears recently to have been restructured, giving hardliners the upper hand. In a lengthy interview with a Caracas newspaper, *El Nacional*, General Enrique Medina Gomez, a long-time opponent of Mr Chavez, declared that the country's armed forces would “not permit Venezuela to descend into chaos and anarchy.”

But the army itself is divided. Mr Chavez has lately held talks with former Lieutenant-Colonel Francisco Arias, a man the president's own diehard followers regard as a traitor to his revolutionary cause. Mr Chavez and Mr Arias spent most of their years in the army conspiring to overthrow the government and were jailed for leading a failed coup in 1992. But the more moderate Mr Arias stood against his former ally during the presidential elections in 2000. Although sincere political reconciliation seems impossible, Mr Arias and his allies among the generals are not keen on a right-wing coup and are prepared to support the government in exchange for certain concessions, particularly, if ironically, the de-politicisation of the army.

The president's good luck is that the civilian opposition is no less wobbly than is the government. The Confederation of Venezuelan Workers has been threatening a general strike such as the one that preceded the April coup attempt. But workers and bosses alike are divided over the wisdom of this. Also divided is the “Democratic Co-ordinator”, a recently formed umbrella movement of opposition parties and pressure groups, which have already started bickering. Luis Vicente Leon, a pollster from Datanalisis, says the only thing opposition leaders share is their desire to see Mr Chavez go. And the president has learned to buy time by setting them against one another.

Mr Chavez looks able to survive until a referendum on his presidency can be held, and possibly even longer. A recent Datanalisis poll showed 65% would vote to throw him out, but the constitution requires that more votes must be cast against him this time than he received in 2000—a tall order.

Might the fast-worsening economy force him out earlier? The government itself predicts that GDP will decline by more than 3% this year; independent analysts say it could be 4.5%, with inflation at 35% and the national currency, the bolivar, down by half against the dollar since January. So bare are government coffers that even congressional deputies have begun to complain that their salary cheques bounce. With official unemployment at around 18%, and more than half the workforce employed in the informal economy, life for the poor—the president's main allies—is increasingly grim. But that will not necessarily translate into anti-government activism. Barring an outright coup, Mr Chavez's ship, for all its leaks, could drift on a while yet.

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Brazil's election

All things to all men

Jul 25th 2002 | SAO PAULO
From The Economist print edition

The contradictory Ciro Gomes's presidential bid springs to life

Get article background

Reuters

Gomes just grows and grows

UNTIL recently, Brazil's presidential contest was shaping up as a straight fight between the veteran opposition leader, Luiz Inacio Lula da Silva of the left-wing Workers' Party, and Jose Serra, the standard-bearer of President Fernando Henrique Cardoso's centre-right coalition. The two soft-left contenders, Ciro Gomes and Anthony Garotinho, were fading away. But Mr Gomes's ratings, which have soared from 9% to 27% in less than two months, have thrown the election—and the financial markets—into renewed turmoil. The *real* hit a record low of 2.95 against the dollar on July 24th after a new poll showed Mr Gomes far ahead of Mr Serra, whose support has dwindled to 14%, down from 21% last month. Investors are shuddering at the thought of a run-off between two leftish candidates—Mr Gomes and Mr da Silva, still the poll leader—both of whom until recently talked of “renegotiating” Brazil's government bonds.

Mr Gomes has been boosted by strong television performances, both in his Popular Socialist Party's advertisements and in a live interview on TV Globo's influential evening news. He has gained angry middle-class voters, who blame the government for recent rises in fuel, utility and transport costs. His reputation for personal honesty is also helping him, though the same cannot be said for all his entourage: this week he sacked an aide implicated in a campaign-funding scandal.

His popularity has surged despite confusion over what he stands for. He presents himself as an anti-establishment leftist. He rails against avaricious bankers and the “oligarchy” that has ruled Brazil for centuries; criticises the government's inflation targets for cramping growth; promises more state aid for domestic firms against foreign competitors; pledges to nationalise the defence industry; and insists that Brazil's public debt is unsustainable and must be “renegotiated”.

Yet, for all his talk, Mr Gomes's backers include some of Brazil's most notorious right-wing oligarchs, such as Antonio Carlos Magalhaes, a former Senate president. In a brief spell as finance minister in 1994 (when he belonged to Mr Cardoso's party), Mr Gomes followed the sort of neoliberal policies he now criticises, such as cutting import tariffs to expose the local car industry to foreign competition. Before that, as governor of the north-eastern state of Ceara, he ran a prudent and efficient administration. And his manifesto includes proposals to simplify the tax system and reform state pensions. Opponents and allies alike have come to disregard his leftish talk and to speak of him as the establishment's “Plan B”, a fall-back to stop Mr da Silva winning if Mr Serra fails.

Will such a plan be needed? Mr Serra still has most of Mr Cardoso's big coalition behind him, and so will get the lion's share of the television slots that will be screened from next month. A seasonal fall in unemployment and some possible cuts in interest rates in the coming months may create a feel-good factor and restore his fortunes.

But if not, and if Mr Gomes goes through to the run-offs against Mr da Silva, what then? Shorn of its own candidate, the governing coalition would split between the two, reckons Gaudencio Torquato, professor of politics at Sao Paulo University, making the final result unpredictable. In any case, economic reality may force whoever wins to continue the current administration's conservative policies. Mr Gomes and other opposition candidates have backed away from the government's proposal that they sign a pre-election

accord with the IMF to reassure investors that Brazil will not default. But any victor would probably have to start negotiating with the Fund, like it or not, soon after election day.

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Religion in Mexico

Staying alive

Jul 25th 2002 | MEXICO CITY
From The Economist print edition

Mexicans are increasingly turning away from the Catholic church

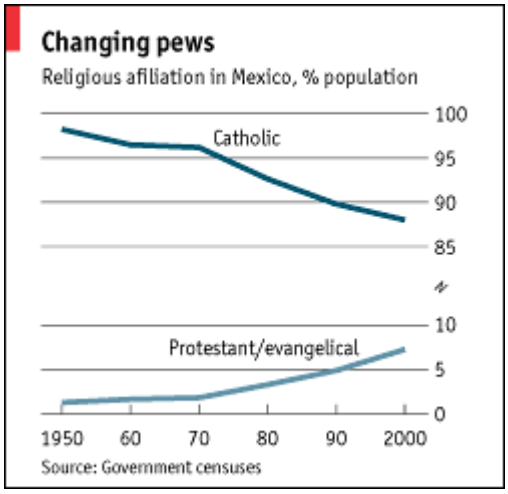
"IT'S a panic measure," says Roberto Morales of the visit of Pope John Paul II to Guatemala and Mexico next week. As an evangelical pastor, he is not unbiased. But even some Catholics are cynical about the real motive for the pope's visit. Although his appearance in Mexico city is likely to produce genuine euphoria, the Catholic church has nonetheless been losing ground in Mexico.

The pope intends to travel first to Canada and Guatemala, arriving in Mexico (God willing) on July 30th. Because he is so frail now, he will stay for only two days, and Mexicans have been obsessing over whether he will make it at all. The authorities, who want to make sure *el Papa* has a smooth ride, are leaving nothing to chance: paramedic helicopters will follow his public appearances, ready to intervene in case he ever looks like becoming a martyr to his work.

The main reason for the visit is supposed to be the canonisation of an indigenous Mexican peasant, Juan Diego, said to have been blessed in 1531 by apparitions of the Virgin of Guadalupe, the patroness of Mexico. The timing of the canonisation is significant. The Catholic church has been losing some of its appeal in the region, and this is part of an attempt to stage a recovery.

Over the past 20 years, Protestant and evangelical churches, groups and associations have been making serious inroads into the Catholic flock. Many of these organisations had their roots in the United States or Europe, but Mexicans or Guatemalans are now setting up their own and exporting their evangelism abroad. In Mexico, the proportion of Protestants in the population—although still small, at 7.3%—has been rising steadily (see chart). Of this, 5% are evangelicals, the source of the proselytising energy in recent years.

Particularly galling for the Catholic hierarchy is the fact that the evangelicals have gained most souls in the poorer, more indigenous states in the south of Mexico. These are precisely the sort of people the pope has been trying to win over with his campaigns against economic inequality and racial injustice, and this is one of the places where Catholic priests since the 1980s have risked their clerical careers by preaching a new "gospel for the poor".



Roberto Blancarte, a sociologist of religion at the Colegio de Mexico, points out that in Chiapas, a state with a high proportion of indigenous people, almost 14% of the population is now Protestant. In Guatemala, which has a far higher proportion of indigenous people than Mexico, evangelism is doing even better. According to Mr Blancarte, the rise of Protestantism in these regions is now the Catholic church's "major worry".

Why have the evangelicals been so successful? According to David Stoll, an American anthropologist at Middlebury College in Vermont, part of their success lies in their firm line against alcohol, which is redeeming many people from the ravages of the bottle. Evangelical groups are also less hierarchical and more accessible than their Catholic counterparts. Catholic priests who work in the indigenous areas complain that the church authorities are making their work more difficult. The Vatican has banned the ordination of indigenous deacons—many of whom have families—for fear they may corrupt the celibate priesthood. When freed from such constraints, many indigenous Catholics turn out to be the most dynamic evangelical preachers.

For Jesuit priests like Serjio Cobo, who heads a Catholic agency that works in Chiapas, the canonisation of Juan Diego is merely a distraction from the real problems the church faces. “The event supports the institutions that oppress the indigenous people,” he says. For many Catholics, the fear is that once *el Papa* has left, nothing will have changed. And the trickle out of the church will just go on.

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Uruguay's economy

Victim of contagion

Jul 25th 2002 | SAO PAULO
From The Economist print edition

Argentina's woes topple a neighbour's finance minister

WITH the help of the IMF and other multilateral agencies, Uruguay's President Jorge Batlle has been striving to stop his tiny country succumbing to contagion from its neighbour Argentina, which is in a deep depression after defaulting on its debts. But things took a turn for the worse this week when, to avoid the collapse of his centre-right coalition government, Mr Batlle had to sack his unpopular finance minister, Alberto Bension. The same day, new figures showed that a growing banking crisis has cut the country's reserves to just $877m, less than a third of what they were at the start of the year.

Mr Batlle pleaded with, and eventually convinced, Alejandro Atchugarry, one of his chief allies in Congress, to take on the unenviable task of running the finance ministry. The president has also sent officials to Washington to beg the IMF to speed up disbursement of the promised loans, totalling $2.3 billion.

The mechanics of this “contagion” are all too simple. The collapse of Argentina's financial system led many Argentines to withdraw their deposits from Uruguay's banks. Despite attempts to discourage them, Uruguayans are now following suit, fearing an Argentine-style deposit freeze. With the bank run draining reserves, Uruguay was forced last month to abandon its currency-band system and let its peso sink freely. Since most bank loans and public debt are in dollars, the devaluation of the currency has only made things worse.

In return for the IMF's aid, Mr Bension had introduced several rounds of spending cuts and tax rises to try to close the yawning gap in the public finances. Opposition leaders hope that with his departure the government will introduce measures to create jobs and reactivate the moribund economy. But it is hard to see how these would be financed. In its fourth year of recession, Uruguay's economy shrank at a 10% annual rate in the first quarter of this year. Rising unemployment and soaring prices for key imported goods—such as petrol, up 60% since January—have brought Uruguayans on to the streets. So far, unlike in Argentina, the protests have been restrained. Uruguay has stronger political institutions than its southern neighbour, but these are being tested to the limits. Eventually, a cheaper currency should boost its exports of farm produce, but Uruguay faces competition from Brazil and Argentina, which have suffered even steeper devaluations.

Mr Batlle insists that a bank-restructuring scheme, financed by the IMF's loans, will ensure the safety of all deposits, and that Uruguay will continue paying its debts. The international aid should allow him and his new finance minister to struggle through to the end of this year. But if the recovery still has not come by then, what next?

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China

Not drowning but waving?

Jul 25th 2002 | BEIJING
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AP

Jiang Zemin is fighting vigorously to hold on to more of his powers

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CHINESE leaders will hold secretive meetings at the seaside in the coming few days that are likely to determine the political destiny of President Jiang Zemin. Their annual informal gathering in the resort town of Beidaihe, 280 km (175 miles) east of Beijing, is more important than ever this year. After Beijing's oppressive summer heat begins to dispel, the Chinese Communist Party will convene a full congress—an event held only once every five years—at which wide-ranging leadership changes will be unveiled. Mr Jiang wants to stay in power beyond the congress despite widespread misgivings among senior party and military officials.

Observers in Beijing say bickering over Mr Jiang's future, as well as his efforts to have his own musings on the nature of communism enshrined in the party charter, could result in the congress being delayed. No date has yet been announced for the meeting, but until very recently it was understood that the party was aiming for a date some time in the second half of September. One diplomat said he had heard that police leave in Beijing had been cancelled from mid-September onward.

Now there is widespread speculation that the congress might not be convened until October or even November. The diaries of some 2,000 representatives from around the country, as well as of all the country's leaders and the army of bureaucrats involved in organising such gatherings (not to mention the hundreds of reporters from China and abroad who will cover the congress), are full of question marks. Diplomats are receiving conflicting information from different Chinese officials who brief them. “It's just absolutely bizarre,” says one envoy.

It had already been considered likely that Mr Jiang will keep his title as chairman of the Central Military Commission (CMC)—in effect, supreme commander of the armed forces—after the congress. A much more interesting question now is whether he might also succeed in keeping his job as general secretary of the Chinese Communist Party. The only certainty is that he will step down as president at the annual session of the legislature, the National People's Congress, early next year. Having served two five-year terms, he is obliged to do so by the constitution.

Many party members and military men would like Mr Jiang, who turns 76 next month, to give up all his posts and hand power over to a somewhat younger generation led by the 59-year-old Hu Jintao, who is now vice-president, a member of the Politburo's standing committee, and vice-chairman of the CMC. But old Communists don't just fade away. Mr Jiang has been orchestrating a campaign to ensure that even if Mr Hu succeeds in name, he himself will remain paramount leader.

Diplomats say that Mr Jiang arranged for a petition to be circulated among military chiefs urging him to stay on as commander-in-chief. A similar petition was circulated among party leaders, but was withdrawn when it became evident that there was little enthusiasm for his keeping the job of general secretary. It remains, on balance, unlikely that Mr Jiang will stay on as party chief. To do so would be a clear vote of no confidence in the succession arrangements so carefully developed by Chinese leaders since the Tiananmen Square crisis of 1989. Despite all his titles, Mr Jiang is not as strong politically as his predecessors, and so cannot ignore overwhelming opposition from colleagues.

Rumours nonetheless persist that Mr Jiang is still lobbying for another term as general secretary. In the last few weeks, the official media have been heaping praise on a speech he gave on May 31st at the party's academy for senior officials. In this Mr Jiang emphasised the need for “unity and stability” and said nothing, at least in the publicly available version, about any forthcoming transfer of power. Nor did he give any indication last week to Jack Straw, Britain's visiting foreign secretary, that he was about to withdraw from the political scene.

Some believe that Mr Jiang has encountered opposition to having his philosophy of the “Three Represents” written into the party charter. This says that new social forces have emerged in China as result of economic reform and that the party must seek to represent them. These forces include private entrepreneurs, a class once regarded by the party as exploitative and banned from membership. Conservatives object to the “Three Represents” because they fear that recruiting businessmen into the party will change its nature and cause its collapse. Liberals dislike the idea of attaching Mr Jiang's name to the theory because it smacks of a personality cult (even Deng Xiaoping's name was not included in the party charter until after his death in 1997).

Rumours of a power struggle should be kept in perspective. There are few indications of the sort of deep divisions within the leadership that led to the nationwide unrest of 1989. All the same, the current antagonisms do not inspire confidence in China's stability. Mr Jiang's efforts to promote one of his protégés, Zeng Qinghong, to the Politburo Standing Committee in order to counterbalance Mr Hu's power is laying the groundwork for some potentially bitter feuding in the years to come. What had promised to be the party's first ever orderly transfer of power is beginning to look rather different.

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India

Crafty Modi

Jul 25th 2002 | DELHI
From The Economist print edition

Gujarat's chief minister aims to make political hay from mayhem

AP

But will they?

ONE of India's most ambitious Hindu-nationalist leaders has caused outrage by preparing to hold early elections in the western state of Gujarat, even though the state has yet to recover from the trauma of Hindu-Muslim riots earlier this year when more than 2,000 people are believed to have been killed, almost all of them Muslims.

Narendra Modi, the state's Bharatiya Janata Party (BJP) chief minister, thinks his party has more chance of being returned to power in Gujarat while memories of the carnage are still fresh in the majority Hindu community's minds than it might in a few months' time. If he is proved right, it will be seen by the BJP as an endorsement of its *Hindutva* (Hinduness) policy.

Criticised for appearing to stoke the riots up instead of damping them down, Mr Modi has been hankering after elections since April, when the killings, rapes and burning of homes were in full spate. He was persuaded by the BJP's national leadership to wait for calm. The violence now is only sporadic, so on July 19th Mr Modi arranged for the state's governor to dissolve the state assembly, six months early. He then asked India's election commission to authorise an early election, probably in October.

These manoeuvres have been widely criticised. Might not an early election stir up communal tensions at a time when there are still sensitive issues to resolve, such as who started the fire on a train that killed 58 Hindu pilgrims and triggered more than two months of violence? Quite so. It is precisely such tensions, Mr Modi presumably calculates, that will inspire the more militant Hindus to cast their votes for him.

At least 12,000 Muslims who lost their homes in the violence are still in refugee camps. Aid agencies say that thousands of others have not returned to their homes, and so will not be able to vote. Critics also allege, probably with some justification, that the Modi administration will not run fair elections. Some even claim it may deliberately stir up new fighting.

These concerns led to quarrels and walkouts in India's parliament this week. The opposition, backed by some parties in the coalition government, demanded that the state be put under “president's rule” (rule from Delhi through the state governor) until elections are held next year. Echoing the views of many, a Marxist MP said that, under Mr Modi, Gujarat had become “a laboratory of *Hindutva* where the entire state administration participated in looting, murder and rape.” There had, he said, been “state-sponsored carnage, mayhem and ethnic cleansing.”

Mr Modi has powerful backing from zealous BJP national leaders, including L.K. Advani, the hardline home minister who was recently promoted to deputy prime minister, and Arun Jaitley, a friend and former law minister who is now the BJP's national spokesman and a general secretary with special responsibility for Gujarat. Privately, many BJP supporters are relying on anti-Muslim feeling in the state to carry the party back to power; though their public line is of course that elections are needed to enable Gujarat to move on from the horrors of the violence. “Democracy is a great leveller and elections are a constitutional imperative that will reduce the current tensions,” says Mr Jaitley.

The BJP was doing badly in local elections before the violence and cannot afford to lose control of the state, which has become the heartland of its Hindu-nationalist movement. Defeat would set a negative

precedent for a series of other state elections in the coming year, ahead of a general election due by 2004. Mr Modi made his move after the rival Congress Party appointed a new Gujarat chief. He is Shankersinh Vaghela, a former top BJP politician. The BJP fears that, if he were given enough time, Mr Vaghela could attract a significant number of voters. That is another reason why Mr Modi is so keen on holding an early election, whatever the potential price in blood.

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The Philippines' economy

8 / 10

Jul 25th 2002 | MANILA
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But watch out for the deficit

Get article background

THIS week's State of the Nation Address, or SONA, as acronym-crazy Filipinos call it, gave President Gloria Macapagal Arroyo a chance to rate her own performance. On the economy, among other subjects, she awarded herself top marks. She pointed to low inflation and a stable currency, in particular, as proof that the economy—which had looked wobbly since the Asian crisis of 1997—was on the mend. And so it seems to be: growth should reach 4% this year; exports, hit by the tech crash, have begun to rise after more than a year of contraction, and business confidence is increasing. But one critical measure threatens to spoil Mrs Arroyo's otherwise glowing report card: the budget deficit. By the end of June, it was running at 92% of the total target for the year. A fail there seems all but inevitable.

The overshoot is all the more damaging, since, as Mrs Arroyo herself admitted, deficit reduction is the “linchpin” of her efforts to restore macroeconomic stability and attract foreign investment. When she took over from the spendthrift Joseph Estrada, at the beginning of last year, she found the public finances in disarray. The fiscal balance had swung from a slight surplus in 1997 to a 4% deficit in 2000. She pledged to hold the line at 4% during 2001, and to everyone's astonishment and delight, managed to do so. But her promise to reduce the deficit to just over 3% this year now looks untenable.

Economists suspect that payments withheld to help meet last year's target, but disbursed early this year, may account for the high spending. Emilia Boncodin, the minister in charge of the budget, argues instead that the government's deliberate effort to bring development spending forward to the beginning of the year is showing up in the figures. She also complains that her cabinet colleagues are too efficient for their own good: whereas in Mr Estrada's time, government agencies only managed to spend about 85% of the money allocated, Mrs Arroyo's team is capable of using every penny on offer.

But the real problem lies not on the spending side, where lower than expected financing costs for the public debt helped keep the government more or less on target. Rather, it is the task of bringing money in that seems to stump Mrs Arroyo. In the first half of the year, the Bureau of Internal Revenue (BIR), the tax-collection agency, raised 12% less than projected. The fact that most of the country's growth stems from a boom in agriculture, which is lightly taxed, did not help. Far more worryingly, the BIR made no headway chasing the Philippines' many tax dodgers.

At the current rate, the Philippines will only collect some 13% of GDP in taxes this year, compared with over 20% in neighbouring Malaysia, and over 50% in some European countries. In her speech, Mrs Arroyo pledged “strong administrative measures” to improve the government's take. She has brought in a respected businessman to shake up the BIR. He, in turn, has started to identify cheats by setting benchmark levels for tax payments for different industries, and then investigating companies that deviate from them markedly. He has also tried to cut corruption among his own staff by transferring some of his senior staff to new districts.

Measures like these should help to raise more money eventually. But in the short term, Mrs Boncodin readily admits, the disruption brought on by the changes might actually reduce revenue yet further. Nor, she says, does the government have many other options. Economists caution against further spending

cuts, since they would eat into the improvements in infrastructure that the Philippines needs to spur growth. Mrs Arroyo, who already seems insecure about her following among poor Filipinos compared to the populist Mr Estrada, would doubtless balk at any tax hikes, as would the country's unruly congress. Anyway, it makes little sense to increase taxes if you cannot collect them.

In narrow economic terms, it might not matter that much if the deficit exceeds Mrs Arroyo's target. Interest rates are low, and domestic and foreign capital plentiful, so there is little risk of the government “crowding out” private borrowers by sucking up funds. But the president herself has put so much emphasis on keeping the country's finances under control that failure to do so might dent public confidence disproportionately. Some observers had hoped that she would take advantage of SONA to explain the government's difficulties and gently deflate expectations. Instead, she stuck doggedly to her target. A scandal over an illegal gambling racket forced Mr Estrada from office; now his successor seems determined to risk her credibility on a high-stakes bet of her own.

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Tajikistan

Wars and shadows of wars

Jul 25th 2002 | DUSHANBE
From The Economist print edition

Tajiks need peace in Afghanistan

WHEN the Taliban regime in Afghanistan was overthrown by the anti-terror coalition last December, the leadership in neighbouring Tajikistan was thoroughly delighted. It seemed to offer hope to a poverty-stricken country still struggling to recover from its own civil war that ended five years ago and cost an estimated 60,000 lives.

The Taliban had been a continuous threat to the stability of Tajikistan, the only country in Central Asia that has allowed Islamists to become part of its government, under the terms of the peace agreement signed in June 1997. The president, Imomali Rakhmonov, strongly opposed the Taliban and supported the Northern Alliance long before the rest of the world began to take much notice of Afghanistan. Most of the world seemed to be waiting only for the Taliban to conquer the whole of the country before, with a show of reluctance, granting them diplomatic recognition. Luckily for Mr Rakhmonov, September 11th has changed the equation, boosting the Tajik government in a number of ways.

First, it enabled Mr Rakhmonov to carry out some long-overdue housekeeping. For example, around 15% of the commanders in the powerful border-control forces were recently sacked. “This could not have been done in 1999 or 2000, or even before 9/11,” says an observer. The role of law-enforcement organisations, the militia and judges are all now under review, reflecting Mr Rakhmonov's new feeling of security.

Peace in Afghanistan, if it lasts, should in principle also offer Tajikistan new possibilities for economic development and trade. Held back by its civil war and subsequent instability, Tajikistan has been slower at implementing economic reforms to make the transition from a command to a free-market economy than the other former Soviet republics. Being landlocked, Tajikistan, potentially an exporter of gold and other precious metals, is dependent on long transport routes and consequently on good relations with its neighbours.

For the present, Tajikistan's economy is still in dire straits. The United Nations reckons that about eight out of ten Tajiks live in poverty. Unemployment is so high that up to 1m souls out of a population of more than 6m migrate to Russia for work every year. Since those lucky enough to find work in Tajikistan can expect an average monthly salary of just $10, it is no surprise that Russia-bound flights are packed. Getting a train ticket can take weeks.

The departure of such a large portion of the male population causes extra social problems at home. Wives are left behind to fend for themselves and to raise their usually sizeable brood of children alone. Those women who are unable to find husbands settle for becoming second or third wives in the hope of finding financial protection and respectability, even though neither they nor their children have any legal rights in case of abandonment.

Reducing poverty and solving such problems are primary goals for Mr Rakhmonov's government. One country the Tajiks would like to see become more involved is Russia, still Tajikistan's principal strategic partner despite America's increased presence in Central Asia. But although Russia continues to keep its 201st motor rifle division in the capital, Dushanbe, and has agreed to set up a military base in the country, this is one former republic in which Russia seems neither able nor willing to invest.

Relations with Uzbekistan, through which Tajikistan's railway runs before reaching Kazakhstan and Russia, remain particularly difficult. In the past few years, the Uzbeks have accused Tajikistan of endangering their security by permitting drug trafficking from Afghanistan and failing to prevent Islamists from attacking Uzbek territory. As a result of this, Uzbekistan decided to plant mines along its border with Tajikistan, without informing the Tajikistan authorities of their location. To date, they have killed at least 55 Tajik civilians and injured over 200.

Tajikistan remains an edgy place in a dodgy neighbourhood. Most Tajiks, though weary of conflict and instability, are well aware that no disarmament followed the end of the civil war. The weapons were simply stashed away, and are ready to be pulled out at any moment.

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Papua New Guinea

The longest poll

Jul 25th 2002
From The Economist print edition

Election chaos taken to the point of logical absurdity

THE election woes of the South Pacific nation of Papua New Guinea (PNG) are beginning to make the hanging, swinging and pregnant chads of Florida 2000 look like minor glitches. In a poll that has run since June 15th, almost half the country's population has been unable to vote due to problems with the electoral roll, and more than 30 people have been killed in election-related violence that has rendered parts of the interior virtual war zones.

Corrupt candidates have used tribal gangs to intimidate voters and steal, torch or tamper with ballot boxes. Presiding officers have been kidnapped, threatened, or have just refused to come forward. The electoral violence is symptomatic of wider problems. Administered by Australia under a League of Nations mandate from 1920, PNG has since independence in 1975 been plagued by lawlessness in the capital, Port Moresby, and tribal warfare in the highlands. While the mineral-rich island of Bougainville's decade-long independence struggle ended in 1998, leaving more than 20,000 dead and 40,000 as refugees, PNG still feels the effects of the separatist conflict in the neighbouring Indonesian province of West Papua.

Electoral results have been declared in more than 80 out of a total 109 seats, but it is unclear how voters in uncounted seats will be represented. The attorney-general, Francis Damem, has asked the Supreme Court to decide on how an election in any particular seat can be deemed to have “failed”. The court is also looking into a request by the electoral commissioner for a ruling on whether a new parliament can sit without all its members having been declared. The poll is due to close on July 29th, before parliament resumes on August 5th to elect a prime minister.

What is clear is that the current prime minister, Sir Mekere Morauta, is likely to go. The opposition has called for his resignation, due to the failure of the majority of his cabinet to win re-election. After coming to power in 1999, Sir Mekere introduced a series of political and economic reforms, including re-engagement with the World Bank and IMF, and a substantial if unpopular privatisation programme. However, unemployment, illiteracy, and the rapid spread of AIDS remain large obstacles to economic development in a country in which nearly 80% of the population lives a largely traditional life based on subsistence agriculture.

If all goes to plan, Sir Michael Somare, a former prime minister and now leader of the opposition, aims to succeed Sir Mekere. Seven opposition parties this week agreed to form a coalition government. Some 50 MPs have committed themselves to supporting Sir Michael's party, and the agreement has the backing of former prime ministers Sir Julius Chan and Bill Skate, a necessity of government formation in a highly divided nation. First, though, the election must be completed.

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Japan

All work and no play

Jul 25th 2002 | TOKYO
From The Economist print edition

Junichiro Koizumi demands new reform plans

Get article background

SO MUCH for summer. Less than two weeks before the end of the current session of the Diet on July 31st, Junichiro Koizumi, the prime minister, handed seven of his cabinet ministers tough holiday assignments. Their mandate: to come up with specific proposals to cut costs and deregulate the areas they oversee by the end of August.

The minister in charge of land, infrastructure and transport was instructed to reduce Japan's expensive and unwieldy public-works projects. The agriculture minister is to overhaul outdated rice-production policies that offer generous subsidies for farmers. The minister of economics, trade and industry must review energy policies and funding for small businesses. The home-affairs minister needs to come up with ways to cut personnel expenses in government, the education minister to trim funds for compulsory schooling.

By setting these, and 20-odd other tasks, Mr Koizumi wants to speed up structural reform, which he has often promised but so far largely failed to deliver. Much to the delight of the finance ministry (whose political head was not given any homework), the proposals are also designed to cut spending next year. This would help curb rising public debt, which has swollen to 140% of GDP over the past decade. Ministers who want to keep their jobs have good reason to co-operate: Mr Koizumi is widely expected to reshuffle his cabinet in September.

The prime minister hopes that fresh plans for reform will lift his collapsed popularity, which has only just begun to recover slightly, according to recent polls. Mr Koizumi, who is under pressure to appoint more of the old guard within his Liberal Democratic Party (LDP) to ministerial posts, may also be trying to set an agenda for reform while he can. Minoru Morita, a political commentator, predicts that if his popularity continues to improve, the prime minister could end up replacing only three ministers. Chikage Ogi, the land minister, and Chikara Sakaguchi, the health minister, represent two of the LDP's coalition partners, who are anxious to let others in their parties take a turn in the cabinet. Toranosuke Katayama, the home-affairs minister, might also go. Should Mr Koizumi's popularity drop, however, he will probably be forced into a more sweeping reshuffle, leaving him with a cabinet more reluctant to reform.

Whether he can pre-empt this by setting an agenda by the end of the summer is uncertain. Ministers are already running into resistance from bureaucrats anxious to preserve their ground. And even if proposals become bills, many could go the way of a much-needed postal reform plan, which was watered down to near meaninglessness by the time it passed the Diet on July 24th.

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Egypt's 50th anniversary

The revolution and its legacy

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From The Economist print edition

Hulton Getty

Egypt's government tries to get an unwilling people to celebrate 50 years of less than glorious revolution

THE country is not in the mood for fun. Its economy and politics are stalled, with strife in the surrounding region stunting hopes of relief anytime soon. Even so, the Egyptian government has lumbered into action with pageantry, parades and speeches to mark the 50th anniversary of the July 23rd coup that toppled King Farouk—and which inspired copycat revolutions across the Arab world.

The fanfare is meant to boost national pride. But it seems instead to have added to the unease of a country that has grown unhappy with both itself and the outside world. A striking number of Egyptians, especially among those who are old enough to remember, draw parallels between the country's present ills and those that sparked the revolution. These include wide disparities in income, unemployment, corruption, a political elite that appears out of touch, frustration over Egypt's seeming weakness in international affairs, and a general sense of drift.

“It just makes me ask, what went wrong?” says a cigarette vendor in central Cairo. He was commenting on the jaunty old newsreel footage showing on the tiny television set he has installed in his kiosk.

Of course, plenty of Egyptians take rightful pride in the achievements of the revolution. Republican governments have added 20 years to the average life span. They have brought roads, electricity and schools to every village. Nobody denies that the revolution saw off the last British occupation forces, nationalised the Suez Canal, dammed the unruly Nile, and launched massive programmes to reclaim the desert for farming.

But the army officers who seized power on July 23rd, 1952 also ended a 30-year experiment with liberal democracy and open markets. The new rulers' impatience for change pushed them to adopt exceedingly blunt instruments such as censorship, central planning, secret police, torture, phoney elections and referendums always won by huge majorities. Egypt has been under some form of emergency law for all but eight of the years since 1952.

Western hostility to the revolutionary regime, which culminated in the 1956 invasion of Egypt by Britain, France and Israel, only bolstered its prestige, and silenced its critics. The initial lustre of the government that emerged under Gamal Abdel Nasser, a pan-Arab nationalist who was both visionary reformer and stern dictator, made Egypt a model for other Arab states. Nasserism became a secular, pan-Arab political

philosophy that many Arabs aspired to.

Through the 1950s and 1960s, army coups as far afield as Algeria, Libya, Sudan, Yemen, Syria and Iraq all produced regimes that sacrificed freedoms on the altar of progress, stability and Arab unity. Many even adopted the same flag, with its red, white and black stripes. Syria went so far as to join itself to Egypt in the short-lived United Arab Republic.

“Nasser's leadership infected Arab nationalism with the germ of authoritarianism, a crippling disease it has suffered from ever since,” writes Sameh al-Qaranshawi, an Egyptian historian, in the respected daily, *Al Hayat*. A recent UN-sponsored report on Arab development, written by Arab scholars, comes to much the same conclusion. The Arab “deficit” in political freedom, it suggests, largely explains the region's long-term under-performance.

Pre-revolutionary Egypt was feudal and venal, but it produced a renaissance in Arab arts and ideas that some now see as a golden age. More recently it has produced a prosperous nostalgia industry. A glut of books and magazines look fondly upon what is seen as a more innocent past. Even decorators and fashion designers have picked up on royalist themes.

Blurred heroism

Yet the debate over the pros and cons of the revolution goes over the heads of most Egyptians. More than half of them are under the age of 20, and have never known any rule but that of Hosni Mubarak, who assumed the presidency in 1981. For most of the rest, decades of state “guidance” of education and the media—one of the strongest legacies of the revolution—have turned the past into a blur of grainy images of heroic moments. But even state guidance cannot disguise the failures, such as Egypt's terrible mauling in the June, 1967, war against Israel.

The government's anniversary celebrations amount to something of a counter-offensive, both against revisionism and the general mood of gloom. Addressing graduates of his alma mater, Cairo Military Academy, President Mubarak described the revolution as “the crowning glory of the Egyptian people's struggle.”

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Bombing Gaza

A blow at peace

Jul 25th 2002 | EAST JERUSALEM
From The Economist print edition

Has Israel blown up more than a Hamas leader, his family and neighbours?

Reuters

Get article background

AT FIRST the Israeli government said it was self-defence against terrorism; it later said that a mistake might have been made. The Palestinians said it was a massacre. Outsiders deplored it, with even the United States saying that “this heavy-handed action does not contribute to peace”. Whatever it was, Israel's assassination of Hamas's military leader, Salah Shehada, will almost certainly lead to more killing in a land already soaked in blood.

In the night of July 22nd-23rd, an Israeli F-16 dropped a one-tonne bomb on Mr Shehada's apartment in Gaza city. The army said it thought that the place was empty, save for the Hamas leader and his bodyguard. But Palestinians and others point out that the building sat in the residential heart of Gaza's most densely peopled town. Aside from Mr Shehada and his guard, 13 Palestinians were killed and 145 wounded. The dead included nine children, one aged two months.

Mr Shehada has long topped Israel's list of Palestinian quarries, wanted for scores of attacks on soldiers and settlers in Gaza, and also, says the army, for planning suicide bombings inside Israel. Ariel Sharon called his death “one of our greatest successes”. He added that “it is always regrettable if civilians are hit.”

Palestinians detect a darker purpose behind the assassination. Last week, Hamas gunmen blew up a bus near a West Bank settlement and machinegunned its civilian passengers. But a suicide bombing in Tel Aviv on July 17th was the first attack inside Israel itself for a month. And, since then, there have been Palestinian stirrings that allowed for hope that the violence would at least be diminished.

On July 20th, Abdul Razek Yahyia, the Palestinians' interior minister, announced a new security plan devised by the Palestinian Authority (PA). The plan, which was well received by Shimon Peres, Israel's foreign minister, is aimed at reducing the “atmosphere for violence” in the Palestinian areas. It requires the gradual withdrawal of the Israeli army from recently re-occupied Palestinian cities, and the gradual resumption of the PA's policing duties, including the confiscation of illegal arms and the arrest of lawbreakers.

Other moves, too, were in the air. At the time of Mr Shehada's killing, say Palestinian sources, plans (encouraged by diplomats from Egypt, Jordan, Saudi Arabia and the EU) for a new Palestinian “ceasefire” were on the verge of being agreed. The initial move would be that militias linked to Yasser Arafat's Fatah movement—such as the al-Aqsa Brigades—declared a moratorium on suicide bombings inside Israel as a first step to a cessation of hostilities.

Perhaps more important, something was in the air inside Hamas itself. On July 22nd, the Islamic faction's spiritual leader, Sheikh Ahmed Yassin, said that his men would stop killing Israeli civilians if the army withdrew from Palestinian cities, lifted the sieges on Palestinian areas, freed recently detained prisoners and ended the assassinations of Palestinian leaders. The sheikh has also been floating the idea of some sort of unwritten pact with Israel that would confine violence to military targets in the occupied territories. This would be akin to the “understandings” (to avoid attacks on civilians) between the Israeli army and Hizbullah during the last years of Israel's occupation of south Lebanon.

While still remote from being acceptable to Israel, all this showed that some change was being contemplated. No longer. In the aftermath of the bombing, Hamas's military arm promised not to rest “until the Zionists see human remains in every restaurant, bus, bus stop and street” (ie, more of the same, many Israelis would say). The al-Aqsa Brigades said that “martyrdom operations” would be continued.

Is this what Israel's prime minister wants: the continuation of a conflict that bars peace talks? Many Palestinians argue that there have been several occasions when Mr Sharon has destroyed periods of relative quiet by ordering the assassination of Palestinian leaders, thus inspiring their militias to revenge. They point to the killing of Abu Ali Mustafa, the leader of the Popular Front for the Liberation of Palestine, in August 2001, and of Raed Karmi, leader of the al-Aqsa Brigades, in January 2002. Both these assassinations were preceded by relative calm, and followed by blood-letting. The horror of the Palestinians' revenge, or so the conspiracy theorists argue, drums up an Israeli “consensus of fear” behind Mr Sharon's policy on not letting go the West Bank.

Most observers have doubted that there can be much truth in such theories. But after yet another untimely killing, the Palestinians' argument is winning new recruits, and not only in Palestine.

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The Qaddafi dynasty

A proud artist come to town

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Oh dear

EVER the nomad, the Qaddafi clan has struck camp and erected a vast white tent facing London's Royal Albert Hall. Under its folds, drum-strumming Tuareg tribeswomen compete for the ears of people queuing for the proms, while Seif al-Islam, a son of Libya's Muammar Qaddafi, presides over a retrospective of 2,000 years of Libyan art.

As in Libya, so in the tent: Qaddafi junior's paintings dominate all others. Libyans may cringe at the degeneration of their homeland from the glorious marble sculptures of Roman antiquity to the showpiece Qaddafis, suffused, says the guide, with an “almost supernatural reality”. Art critics note his remarkable flair for switching style from Dali to Turner to Pollock to cave-painting.

Aged 30, Seif is staking his claim as Libya's future philosopher-king. But his artistic debut in the gardens of Kensington Palace is not without British backing. Aside from his posse of bodyguards, most of those trooping to admire his tent, and sip his champagne, were contractors, hoping for a share of Libya's $15 billion annual oil revenues. And only last month, as part of Libya's post-Lockerbie rehabilitation, Britain's Arabists assembled to fete the foppish young man at Chatham House, a British think-tank favoured by the Foreign Office.

The conversion of socialist republics into dynastic states is not without precedent. Two years ago, Syria, the one-time heartland of Arab revolution, anointed a British-trained eye-doctor, Bashar Assad, to be its hereditary leader. The anti-royalist rulers of Iraq and Yemen are both prodding their progeny into positions as sons-in-waiting. In fact, after a half-century of Arab rivalry between the republican and royalist blocks, there is now little to choose between them: as a rule they are all absolutist, *anciens régimes*.

Fortunately for Seif, his main rivals have been busy counting themselves out of the running. One younger brother, Saadi, captains Tripoli's Al Ittihad team, and as simultaneous head of the Football Federation awards himself all the trophies. On the rare occasion he loses, his bodyguards have been known to open fire on the crowds. Another brother, Muatasim, was spotted squirting fire-extinguishers at Italian police. Mohammed, the eldest and most sober, studied engineering at Liverpool University, but his mother is Colonel Qaddafi's estranged first wife.

Which leaves Seif, who insists he has no such ambitions. As a student in Vienna, he went to university armed with two Bengali tigers, though he has left them behind to study global governance at the London School of Economics. Fittingly, his Kensington collection is titled “The Desert is not Silent”. If only, wince hapless Libyans, it were.

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African peace deals

On Sudan's horizon, maybe Congo's

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From The Economist print edition

Is peace busting out all over Africa?

EARLIER this year, brutal civil wars in Angola and Sierra Leone came to an end. This week, tentative deals were struck to end two even bloodier conflicts. On July 20th, Sudan's Islamist government and its predominantly pagan rebels agreed a framework for ending their 20-year war, estimated to have left 2m dead. Two days later, Congo and Rwanda announced plans to end their fight (four years; maybe 3m dead in Congo's complex war).

AP

If Sudan means what it says, all will be well

The Sudanese deal looks the more hopeful. For over a year, the government and the southern rebels, the Sudan People's Liberation Army (SPLA), have been under intense international pressure to end what has become an unwinnable war, tearing the country across its middle.

The agreement, coming at the last gasp of a regional peace effort, seems surprisingly generous on the government's part. After five weeks of talks in Machakos, a town in Kenya, the government has promised the southerners an immediate share of power, exemption from Islamic law and, eventually, self-determination. It appears, in short, to have thrown in its hand.

But has it? Sudan has made similar promises before. In 1997, a breakaway rebel faction was enticed with a similar deal, which failed to materialise. In 1998, southern Sudan's right to secede was enshrined in the Sudanese constitution, but denied in subsequent peace talks. Yet the government may now need peace. Dissent is mounting at home, and condemnation abroad. The economy is bankrupt. Peace, after further talks in Kenya next month, would bring plaudits and cash.

Even so, it seems unlikely that the government is really prepared to pay for these benefits with the loss of the south, including 75% of the country's oil reserves. Many issues remain to be resolved. The most important concern the sharing of power and wealth during an agreed six-year transitional period, and the specifics of the referendum on self-determination that will follow the transition. If the government were to offer the SPLA a mean hand in the transitional government, the rebels might well decide to continue the war.

But the SPLA is not as well-placed militarily as at first seems. Although it controls 80% of southern Sudan, and is currently resisting an intense offensive near the government's oil-fields in the centre of the

country, it has not been able to launch a counter-attack to stop the oil flowing. The government is using its oil revenues to buy increasingly high-tech weapons. With these, it is smashing the rebels' rudimentary logistics. In another year or so, the rebels must start losing ground.

Viewed as a game of bluff, the timing of the deal makes sense. At issue are Sudan's relations with the United States. Although Sudan remains on America's list of terrorist sponsors, there have been constructive contacts since September 11th. But America's relative friendliness depends on the Sudanese government showing a commitment to peace. The talks next month will reveal whether Sudan considers that it has shown enough already.

The pact between Congo and Rwanda, which was struck in Pretoria this week after hasty talks, seems even more obviously to be a ploy in a well-established game of bluff. Rwanda has repeatedly said it will withdraw from eastern Congo when the genocidal Hutu gangs it chased there in the 1990s have been rounded up. Meanwhile, it inflates the Hutus' numbers and continues to loot Congo. Congo, for its part, has repeatedly offered to disarm the Hutus on Rwanda's behalf. Meanwhile, it supplies them with arms.

According to the terms of the new agreement, which still requires both presidents' approval, an independent panel, composed of UN and South African officials, will establish the number of Hutus remaining in Congo. The panel is then expected to monitor compliance with a UN effort to disarm these Hutus, and Rwanda's simultaneous withdrawal.

The potential pitfalls are myriad. Most of the Hutus are hidden in the corrupt ranks of Congo's army, while the rest lurk in the remote forests of eastern Congo. Even if the Hutus can be found, the UN's ceasefire-monitoring force is mandated to disarm them only on a voluntary basis.

The Congolese-Rwandan agreement, like the Sudanese one, is largely a result of American diplomatic pressure, in this case brought to bear on Rwanda. Whether either deal will eventually lead to peace depends on further international involvement. With donor-countries eager to engage with Sudan, both north and south, the agreement there stands a chance. The Congolese one has to be more doubtful, at least so long as the UN mission in Congo is forced to struggle on with a pitifully small complement and a weak mandate.

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The euro-zone's stability pact

Rules are made to be bent, aren't they?

Jul 25th 2002 | BRUSSELS
From The Economist print edition

Some of the 12 countries that use the euro are struggling to stick to the strict fiscal policies that they have signed up to. Will they change the rules instead?

Get article background

THE European Union's “excessive deficit procedure” hangs like a sword of Damocles over the finance ministries of the euro-zone. This week the European Commission was expected to invoke it for the first time. The likely victim: Portugal.

Under their “stability and growth pact”, the 12 EU countries that use the euro promise never to run a budget deficit above 3% of GDP. If they do, in theory they can be fined up to 0.5% of GDP. Portugal will soon admit that its 2001 deficit was around 4%. With so clear a breach, the commission will have little option but to start proceedings. But it could be years, if ever, before Portugal has to pay up. It can expect a couple of years to put things right before any fine is enforced, and each step in the procedure has to be endorsed by the EU's Council of Ministers. The national ministers assembled there will bend over backwards to be nice: who wants to impose a swingeing fine on a friend? Besides, some are all-but rule-busters themselves.

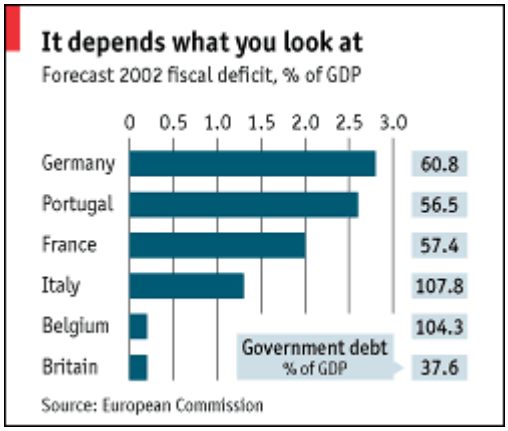
But Portugal has one particular vulnerability. It is one of four poor EU members that get “cohesion funds” from Brussels to help them catch up with richer ones. That money, more than *euro*6 billion ($6 billion) over six years, might have to be suspended at once if the council allows the deficit procedure to go ahead. The legalities are obscure; the commission is looking into them. But the consequences could be grave for a small country already having to tighten its belt, and long reliant on big infrastructure projects to boost growth.

Portugal illustrates the flip-side of euro-zone membership. It has seen the benefits: lower interest rates, no more roaring inflation and weak escudo. The government and consumers have gone on a binge: the current-account deficit is near 9% of GDP. Use of the euro protects Portugal from a run on the currency. But the rules are there to stop one reckless government endangering the currency and credit rating of all. Even if Portugal is never actually fined, it cannot run huge deficits for ever. Its new centre-right government is already under heavy pressure from its euro-zone partners, and cutting back. The economy may shrink this year.

Yet a small country cannot really affect the euro. In contrast, Italy, France and Germany—jointly, 70% of the euro-area's GDP—could. It is their adherence to the pact that really exercises officials in Brussels. None of the big three is forecast to breach the 3% deficit-limit this year. But all are bending another part of the pact, which requires all EU members to aim for budget balance in normal economic times. All have promised to reach balance by 2004. But it is increasingly apparent that the big three want to wriggle off the hook.

At a recent EU summit, France asked for an extension of the deadline to 2007—and when that was refused, it announced that it would not feel bound to respect its pledges, if its economic growth fell below 3%. The Italians have also announced that, in their view, the pact has been loosened and that they will proceed with tax cuts and extra spending on education. Germany, whose deficit

may hit 2.8%, is nearest the limit. It has promised solemnly to rein in spending, in exchange for avoiding a formal warning from Brussels earlier this year. But that promise too may be bent: Germany has a general election in September. And the whole EU risks a worsening of the economic climate. So the commission may later this year find itself in the embarrassing position of trying to issue warnings to the three biggest countries.



A public-relations problem to be sure, but is it anything worse? Optimists point to the euro's recent swift rise against the dollar. Financial markets are far more worried by America's corporate scandals than the twists and turns of the stability pact. Maybe, respond the commission and the European Central Bank, but the point of the pact is not to influence the daily gyrations of markets. The real concern is that most euro-area countries have ageing populations and large, unfunded pensions liabilities. If they cannot control their budgets now, they will face ever worse problems as the years roll by.

So why not revise the pact, to aim it more precisely at these concerns? For example, some French officials argue that Brussels should be less strict with countries that have relatively low levels of public debt. A budget deficit, they argue, is one thing in heavily indebted Italy (whose deficit forecast for this year some in the commission much doubt, after a statistical wrangle that hiked the Italians' claim of 1.6% for last year to the commission's 2.2%). A deficit is less serious in France or Germany, whose public balance-sheet is in a better state. And not all types of public spending are the same. Britain is not in the euro-zone, but is committed to budget balance in normal times. Unfair, say some in London: we have little public debt and badly need to spend on public services. Surely the EU should distinguish necessary investment from loose current spending that brings persistent structural deficit?

So far the commission seems unconvinced. It says it already takes debt and pensions and the like into account when issuing its fiscal advice. But it will not consider letting some countries ignore the 3% limit or defer balancing their budgets. The Eurocrats know that EU governments have already proved worryingly adept at finding loopholes in the stability pact, and are disinclined to introduce new ones.

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France's government

Squabbling and spending

Jul 25th 2002 | PARIS
From The Economist print edition

The politicians want to spend; the finance minister has to find the cash

ROLL on the August holiday, at least for Jean-Pierre Raffarin, two months into a tiring stint as prime minister of France's first centre-right government for five years. One reason for his tiredness is simple enough: since Mr Raffarin has promised a “grassroots” approach to all that ails the nation, he now has to criss-cross the country listening to the grass grow. But there is a second cause: a constant struggle to stop cabinet squabbling, or at least to keep the squabbles from being aired in public.

Since coming into office immediately after the re-election on May 5th of President Jacques Chirac, Mr Raffarin has had a hard job keeping his ministers in line, in his first, interim government as in the present one, formed on June 17th after the election of a new parliament.

A striking example came in early June, after France's family doctors, by dint of several strikes, won an increase in consultation fees. The question for the government is how to finance it. The social-affairs minister said the public “will have to accept that they have to pay for their health.” A few days later, the minister for small and medium businesses said the only way was by an increase in payroll charges: “Anyone who says otherwise is a charlatan.” Bring on the charlatans: Jean-François Copé, the government's spokesman, said a rise in the main social charge had never been considered, and the health minister says repeatedly that there is “no question” of that.

In which case, how will the finance minister, Francis Mer, a former steel boss, balance the books, especially since the budget deficit is likely to be 50% worse than was predicted by the previous left-wing government as recently as February?

Poor Mr Mer, unused to politics, occasionally calls a spade a spade. This month he admitted that, though income tax will fall, as promised by Mr Chirac, by 5% for 2002, it is “a little premature to pronounce now on future cuts.” His junior minister, Alain Lambert, says breezily that next year there will certainly be another tax cut of “6, 7, 8%, I don't know.” Mr Lambert once declared that tax cuts for the better-off would be matched by an increase in the “job bonus”, a sort of tax credit for those too poor to pay income tax. He had to backtrack. He has said that civil-service numbers will fall next year; Mr Mer says that “at this stage, one cannot tell”.

Can Mr Raffarin get his ministers working as a team and “on message”? The trouble is that the message dictated by President Chirac is full of contradictions: France is to become more business-friendly, with lower taxes and payroll charges—but the government is also to throw money into job-creation, prisons, police and care for the elderly and handicapped. Even were the economy to grow at the 3% a year assumed by Mr Chirac, the arithmetic would be difficult. In fact, growth is likely to be lower, the figures will not add up and Mr Mer will have one headache after another.

His bad luck, seems to be Mr Raffarin's reaction. To his camp, keeping grassroots support matters more than balancing the books. Price rises are threatened, or happening, for petrol, telecoms, gas, electricity, trains and buses. So those households—half of all—below the taxable level must be protected. How? Jacques Barrot, leader of the main party in parliament, says cheerily: “The prime minister will see it gets done in the autumn.” Refreshed from his holiday, no doubt, while Mr Mer sweats to get two and two to make five.

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Driving in France

C'est la mort

Jul 25th 2002 | PARIS
From The Economist print edition

But the minister has ideas

TAIL-GATING motorway madmen, lane-weaving motorcyclists, alcohol-flushed delivery drivers: will those French road-users whose antics last year caused 8,160 deaths soon have to mend their ways? In his July 14th address to the nation, President Jacques Chirac declared himself “absolutely horrified that France's roads are the most dangerous in Europe.”

Rightly so. In Germany, last year's toll (defined as death within a month of the accident) was 6,982, despite higher motorway speeds and a population a third larger. In densely-packed Britain, with a population equal to France's, the tally was a modest 3,443. Hence some stern words from the new transport minister, Gilles de Robien, and an “action plan” to be launched after the *rentrée* in September (which, on past form, will have killed off hundreds of the returners). One idea is to set up specialised “highway police”. Another is a total ban on alcohol—now permitted at 0.5 grams per litre of blood—at least for inexperienced drivers. Another, an instant fine if the toll-booth ticket shows a driver has covered a motorway distance at more than the legal 130kph (81mph).

It might happen, though the restaurant lobby will no doubt scream. But does Mr de Robien seriously expect the French to accept other notions coming out of his ministry, notably an aircraft-style “black box”, or an alarm that sounds every time they exceed the speed limit? He thinks such devices could be installed in public-sector vehicles and in those of companies willing to “volunteer”. Some might. How their drivers would react is another matter.

Instead, the minister might care to reflect on a couple of mysteries that so far have escaped his department's attention. Why are driving standards so bad, when the driving test is so complicated and learning to drive, at a minimum of around $700, so expensive? And why do so many policemen, by not using their indicators, going through red lights and, in the case of the motorcycle police, riding the wrong side of traffic bollards, so often set a bad example? As for President Chirac, his conversion to road safety is a somewhat tardy: in a book last year his former, long-time chauffeur, Jean-Claude Laumond, boasted of driving his boss at speeds that a rally-driver might envy.

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Racism in Russia

There are thugs and thugs

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From The Economist print edition

A new law against extremism is being extremely misused

TO JUDGE from its representatives, violent Russian nationalism holds special appeal for confused, skinny, sickly-looking suburban youths with unhealthy skins. That, at least, describes five young men now on trial accused of taking part in a racially motivated rampage at Moscow's Tsaritsyno outdoor market last October, which left three people dead. This is the first trial of its sort in Moscow since President Vladimir Putin declared war on extremism this spring.

The five, crowded into a small metal cage in the stuffy courtroom of the Moscow city court (a standard Russian way of displaying people on trial), will no doubt be found guilty. Their trial is a show-case meant to send a message rather than mete out justice. The message, however, is about as confused and unhealthy-looking as the young men chosen to carry it.

A law on extremism, proposed by Mr Putin himself and passed by the parliament, is awaiting his signature. It followed several embarrassing incidents: threatening letters sent by Moscow neo-Nazis to foreign embassies, declaring a “war on foreigners”; a booby-trapped anti-Semitic sign blowing up in the face of the woman who tried to remove it; a riot in the centre of Moscow, after Russia's World Cup footballers lost to Japan's, at which the rioters focused on Asian-looking passers-by.

The law was rushed through the parliament in two weeks, over the fierce protests of human-rights advocates, who claimed its vague provisions could be used to close any organisation making street protests. The bill had the heartfelt support of Vladimir Zhirinovsky, a political showman once famous for his rabid anti-Semitism.

Though this law is not the one invoked in the Tsaritsyno case, its spirit—defined by the head of the pro-Kremlin faction in the parliament as “responding to violence with violence”—floats around the courtroom. On the first day of the trial, one defendant tried to withdraw his confession, saying it was beaten out of him by the investigating policemen.

The young man initially admitted to buying 150 metal bars and distributing them to the participants in the rampage. Oddly, police have not found either the people who sold the bars or even one of the 150 to whom they were given. Out of 32 prosecution witnesses, so far only one has showed up; the rest probably fear revenge from other Moscow skinheads if they do. But the young man's lawyers had no trouble finding medical evidence that after the interrogation he had a whole array of fresh bruises on his body.

The trial shows how hard it will be to rid Russia of the ethnic intolerance that has quietly grown in recent years under the blind, and occasionally benevolent, eye of its government. Shaken national pride, a brutal war in the Caucasus and years of mismanaged reforms have landed many without perspectives but with a clear enemy to vent their anger on.

Movies stereotyping Caucasians and openly promoting violence against them have been selling out in recent years. Bands have made careers on merry songs about “killing the nigger”. Those who knife some African student mostly go unpunished, since the police mostly don't care, and wouldn't catch them if they did.

Movies stereotyping Caucasians and openly promoting violence against them have been selling out

In the Krasnodar region, in the far south, anti-Semitism and persecution of Caucasians became all-but official policy under a former governor, Nikolai Kondratenko. Mr Kondratenko is not, however, awaiting trial for extremism, but

enjoying the cosy life of a member of the upper house of the parliament, complete with a medal for his “distinguished service to the fatherland”. Moscow's mayor, Yuri Luzhkov, pays lip service to tolerance, but the city police keep on stopping dark-skinned or Asian-looking people to “check their passports”, while refusing to react when the same people get bludgeoned in the metro by groups of skinheads.

The message has been heard in the big-city suburbs, where most of the dissatisfied young men reside. “Spiritually, we have lost an entire generation, and now it is practically impossible to reach them,” an education-ministry official sums up the results. It will take more than a clumsy law, violently incompetent police and a handful of caged teenagers to put that right.

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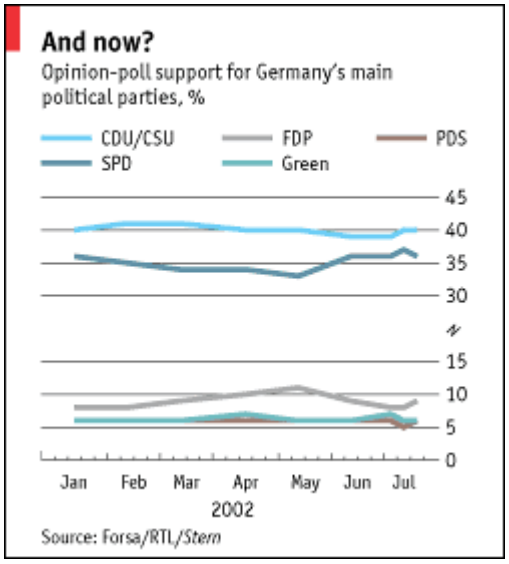
Germany's pre-election politics

Another goodbye

Jul 25th 2002 | BERLIN
From The Economist print edition

Opinion polls barely show it, but the Scharping affair does Schröder no good

Get article background



TWO months before an election, with the government behind in the polls, is a fine time for a minister to fall into disgrace. *Stern*, a weekly magazine, revealed that Rudolf Scharping, Germany's defence minister, had received the equivalent of $76,000 in 1999 from a public-relations man, one Moritz Hunzinger. Mr Scharping refused to resign, saying that would look like an admission of wrongdoing, which he denies. So on July 18th the chancellor, Gerhard Schröder, sacked him.

The chancellor has rediscovered his remarkable talent for losing people. Mr Scharping was the first minister to depart for 17 months, but the eighth in less than 3½ years. And only two days before he was fired, the government had forced out Ron Sommer, boss of Deutsche Telekom. Fair enough, shares in the debt-laden telecoms giant are worth only about a tenth of their peak price. But the shambles has not aided the government's standing (or wealth: it holds 43% of the shares).

Is the sacking of Mr Scharping the last nail in the hopes of Mr Schröder's Social Democrats, already three to six percentage points behind the centre-right Christian Democrats and their Bavarian allies, the Christian Social Union, in opinion polls? You might think so. The pollsters do not. One poll says 54% of voters reckon the sacking will make no odds; 21% say it will hurt Mr Schröder; 20% that it will help him.

Mr Scharping was damaged goods. His days as the Social Democrats' top man are long gone

One reason is that Mr Scharping was damaged goods. Once he was the Social Democrats' top man: their youngest-ever leader and candidate for chancellor, no less, in 1994, when he lost to Helmut Kohl. Those days are long gone. So is his past reputation for unrelieved colourlessness. Many thought him lucky to keep his job last year, when he cavorted in a swimming-pool with his girlfriend for a glossy magazine. German voters do not actively object to men who like women, though, for some, marriage puts its own gloss on them; the attractive 38-year-old attached to Mr Schröder is, after all, his wife (albeit his fourth). But the snaps of the defence minister's frolics appeared just as the cabinet was due to discuss sending troops to Macedonia. He also had to fend off allegations that he had used military aeroplanes to visit the lady.

Nor was Mr Scharping's the only name in Mr Hunzinger's contacts book. Politicians of all sorts visit his “political salons”. It has been revealed that he lent a young Green member of the Bundestag, Cem Özdemir, a large sum to pay a tax bill. Besides, these are but part of a series of whiffy stories about politicians in general, not just progressive ones. The Christian Democrats are still in the shadow of a party-funding scandal. This week, separately, the Christian Democrat justice minister in the state of Brandenburg resigned after a tale of fishy property deals while he was an official in Mr Kohl's government.

Yet none of this makes Mr Schröder any better off. His party is much less popular than he is, and still behind in the polls. With perhaps 30% of voters undecided, Mr Scharping's sacking was a distraction the chancellor could have done without.

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Italy's media

RAI and other wrongs

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President Ciampi wants media reform. What he has got is a political circus

AP

Ciampi in presidential mode

“PLURALISM and impartiality of information.” These, wrote President Carlo Azeglio Ciampi to Italy's parliament on July 23rd, are “essential tools to build a full democracy.” So let there be a law to ensure them. Who could disagree? Not Silvio Berlusconi, though he happens to combine being prime minister, and so at one remove boss of the state broadcaster, RAI, with being boss of most of Italy's private-sector television too. He countersigned the presidential message “readily and with satisfaction”, he told his fellow-citizens, albeit adding caustically that there hadn't been much pluralism around (he meant at RAI) in the days when he was in opposition fighting a centre-left government.

Whoopee, crowed today's opposition, gleefully seizing on Mr Ciampi's message as a tool against the feeble draft law on conflicts of interest that is supposed to sort out those of Mr Berlusconi. It has still to go through the lower house, and to get the president's signature—which he can refuse. Mr Berlusconi's own ambiguous media role was plainly at the centre of Mr Ciampi's thoughts, and the president has been uneasy about him for months; an unease not lessened by the prime minister's recent suggestions that Italy needs a directly elected prime minister, just the job for one S. Berlusconi. So, although the courtesies were observed this week, fresh tensions between the two office-holders are on the cards.

Yet there is another issue: remember it, the media? Mr Berlusconi was actually right about RAI: it isn't impartial. The lesson comes oddly from a man whose political allies in February appointed a friendly new RAI board that has already busied itself gagging hostile old journalists. But it is true, as his critics complain now and as he complains of the past. Mr Berlusconi's television tycoonery is a problem in itself. But it has only made the trouble with RAI more visible, not created it.

Some think the answer is to privatise RAI. Mr Ciampi believes in its “central” role. If Italy's politicians, for once, could forget the politics of the issue and look at the substance, they might devise the rules for a RAI that would deserve that role.

That'll be the day. If it ever comes.

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Poland's economy

Nice holiday, pity about the job

Jul 25th 2002 | WARSAW
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The government has a plan for economic revival

Get article background

THE Poles take summer almost as seriously as the French do. Few of them, canoeing in the Masurian lakes or sprawled on silvery Baltic beaches, bothered with the details of a crisis package pushed through the cabinet this week by their new finance minister, Grzegorz Kolodko. What mattered to them was that the government had admitted there was a crisis.

Not before time. Blame it on the last government maybe, as this one does, but a crisis there is. Unemployment is 17%, and likely to rise in the autumn. The Szczecin shipyard in the north-east filed for bankruptcy in June, devastating that area's already weak economy. Many companies are failing. Negotiations on joining the European Union are going badly: the terms offered to Poland are not generous enough to guarantee acceptance in the referendum planned for next year. After 12 years of painful reforms and heroic restructuring many Poles feel the economy is sinking.

Mr Kolodko's package throws a lifebelt to some floundering businesses, especially in coal-mining and the arms industry. Companies will earn tax breaks and have some of their debt to the state forgiven in return for yet more restructuring. Many in Warsaw see this as throwing good money after bad. Which companies will get the benefits? Those with close ties with the government? There is certainly plenty of debt to forgive. The coal industry owes the state $4 billion. The state railways owe $2 billion and have paid no social-insurance dues for employees since January.

Mr Kolodko's package will buy the government time: workers who had threatened to spend their holidays striking and marching on Warsaw will stick at their barbecues, at least for now. What it cannot do is tackle the central concern of what Poland will export to support its 40m people: if not ships from Szczecin, then what? The trade deficit for the first five months of the year was $6 billion. For all the efforts of the former finance minister, Marek Belka, and the central-bank governor, Leszek Balcerowicz, the budget deficit will rise this year to about $10 billion, or 5% of GDP.

Mr Balcerowicz, who guided Poland through its early post-communist reforms, is pessimistic. He reckons the economy will grow by 1.5% at most this year, far short of the 5% that many Polish economists think is needed to cut unemployment. Great news for ordinary Poles when they come back to work—if there is any.

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Charlemagne

Finland's Paavo Lipponen

Jul 25th 2002
From The Economist print edition

Finland joined the EU long ago. Should it now join the new-style NATO too?

YEARS ago, there was an unwise British lord. No rarity, it's true, but this one was so unwise as to combine chairmanship of a thing called the British Overseas Trade Board with telling the then European Management Forum in Davos that Finland was behind the iron curtain. Murmurs of disbelief rumbled round the hall; in one strange minority language, murmurs of rage. Milord was soon forcefully put right, and duly corrected himself. Yet he had some thin excuse. To north-eastern Europe, Finland's success in staying out of the Soviet bear-hug was a near-miracle; its long-time (1956-81) President Urho Kekkonen was a world authority on dilly-dally, compromise, yes-butting and agreeing when it didn't matter but not when it did. Yet farther west, the word was “finlandisation”—the idea, less than discouraged by that country's far-left trade-union leaders, that non-alignment was quasi-communism and that today's neighbour of Russia must be tomorrow's satellite.

And, hey presto, how things have changed. The Baltic states are independent, nay eager to join the European Union and NATO. Russia, once hostile to their dreams, is almost in bed with NATO itself. How is Finland to respond? Emotionally part of the West for decades, it has been an EU member since 1995. It already belongs to NATO's “partnership for peace”; why not, some Finns are now asking themselves, go the whole hog?

Ex-president Martti Ahtisaari thinks that is what, eventually, his country will do; today's President Tarja Halonen sees no need; 65-70% of Finns are against, only 20% for. On poll evidence, a fifth of armed-forces officers favour joining as soon as possible, a quarter say no to membership at all. The “rainbow” coalition led by the Social Democratic Paavo Lipponen, prime minister since March 1995—longer than any other EU head of government—in April agreed to study whether Finland's airfields and ports were technically suited to NATO forces. But he is in no hurry: a cross-party committee, opposition included, will report on the country's security needs in early 2004. “We all agree on non-alignment,” he says, which (as Mr Kekkonen could never say) “includes the right to decide for ourselves.”

A fifth of armed-forces officers favour joining as soon as possible, a quarter say no to membership at all

The issue is seen as one of foreign policy, not defence. The army, says one observer, doesn't think much of the NATO troops its peacekeepers have met abroad; and Finland, says Mr Lipponen, anyway has “solid” defences of its own, its small regular force backed by 400,000 reservists. Though many say the same, in a real-world war this would be nonsense; but then the only imaginable enemy also lives in the real world. On the other hand, NATO is changing its skin, from defensive alliance to a semi-political peacekeepers' club. Why not join, if the neighbours are doing so and big brother in Moscow does not object? Small countries carry little enough weight; why reject this way of modestly increasing it? “It's important to have the NATO option,” says Mr Lipponen's interior minister, Ville Itala, leader of his Conservative allies. The opposition Centre Party too, the rural and northern rival of the Conservatives, at a party congress this summer formally replaced its old hostility to any military alliance with readiness to look at the idea and the arguments.

These are not quite such a clear “foreign affairs, yes, defence, why bother?” as they sound. After all, the Baltic neighbours aren't in NATO yet, and may never be; and Sweden has barely begun to think about it. On the other side, though big brother's claws are sheathed today, they still exist, and who can foresee the Russia of 2020? Finland was Russian-owned from 1809 to 1919, and cynically attacked by Stalin in 1939. Fighting heroically, the Finns saved their skins then, took revenge, with German aid, after 1941, and were duly punished in 1944, losing an eighth of their land. They have not forgotten history. No official Finn would dream of saying it, but it might one day be comforting to have, yes, allies. If political leaders are willing, voters probably would be; this, after all, is a country where foreign affairs were for

decades almost the private business of its president.

Squaring the EU circles

Finns have another worry abroad, the enlargement of the EU. Though, unlike Swedes and Danes, they use the euro, few care much for the EU: only one in five, half the EU-wide average. And though most would happily see it widen, they fear an influx of Balts under its rules on free movement. Finland also needs an EU that both works and yet does not trample over small members to do so. Mr Lipponen has to square these circles. He says yes to enlargement, but “get the first new countries integrated”— he means, nearer EU levels of wealth and wages—“and don't make loose promises to further ones. We can't swallow more.” And how can a wider EU be run? He is firmly against any sort of big-country *directoire*, and the privileged inner circle it would imply. For the same reason, let the (intergovernmental) Council of Ministers be “the strategic policy-setter”, but “don't tilt the institutional balance and relegate the commission.”

Wider EU or not, Finland already sees the foreigners at it gates. To British eyes, they are hard to spot. Finland has its own Swedish-speakers, with a party of their own that regularly gets 5% of the vote. But resident aliens are few indeed, and the arrival of a mere 40-odd asylum-seekers is front-page news. Yet illegal migrants from Estonia, just across the water, are already a worry. Drugs, organised crime, prostitution: not unfairly, much is blamed on them. Finland belongs to the “Schengen” group of EU countries that have scrapped internal border controls; so it is keen that the EU newcomers should build strong external ones. The unspoken fear is not Balts; it is tens of millions of impoverished Russians. The land frontier with Russia is long, but hard for Russians to reach and sharply policed by both sides. But imagine Russians, once in Estonia, facing no controls at the quays of Helsinki. Finns are tolerant enough, say a bunch of tattered Somalis. But tolerance—ask the Dutch—has limits.

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Labour and the unions

Of strikes and rumours of strikes

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Guardian

Britain's trade unions are not the force they used to be. But they can still cause trouble for the government

THE multiple recounts; the allegations of chicanery; the belated admission of defeat—they all seemed familiar. Perhaps the rancorous contest between Derek Simpson and Sir Ken Jackson for the joint general-secretaryship of Amicus, Britain's second-biggest union, didn't have quite the drama, or the import, of Bush versus Gore. But Mr Simpson's victory last week, after Sir Ken's eventual concession, was widely greeted as a symptom of a new era of industrial relations in Britain—or rather, of a return to an old era of union militancy.

The replacement of Sir Ken, an ally of the prime minister, by a former communist, in a union that had been a bulwark of the Labour right, is bad enough for Tony Blair. But Amicus is only the latest in a series of unions to choose such inconvenient leaders. Two other leviathan unions, and the Trades Union Congress (TUC)—whose conciliatory current boss, John Monks, has helped Mr Blair to portray the Labour movement as sane and respectable—will also change hands soon.

Meanwhile, industrial unrest has been manifesting itself in a more practical form. On July 17th, around 750,000 council workers, from librarians to binmen, staged a one-day strike; two more national stoppages are planned. On the 18th, a tube strike obliged Londoners to stay at home or walk to work. Strikes on the railways are becoming almost as regular as the trains. Postal and airport staff, and tube workers (again) are all grumbling. The firemen are demanding a 40% pay hike—or else.

All of which has provoked comparisons with the “winter of discontent” of 1979, which helped to destroy the last Labour government and brought in Margaret Thatcher. The analogy, though, is misplaced: many of the now-rumoured strikes may not materialise; and on closer inspection, Mr Simpson seems to be a not unreasonable sort of bloke, who denies that his election constitutes a “smack in the teeth for Tony Blair”. Mr Monks, of the TUC, considers the idea “that unions and the government are completely at each other's throats” to be “totally exaggerated”. This rash of strikes, he argues, only seems exceptional because of their recent rarity.

Still, while the disruption may be small in comparison with the upheavals of the 1970s and 1980s, it is far from negligible. And the events of the last two weeks have suggested a swelling dissatisfaction among union members with the Labour Party—a party that, a hundred years ago, the unions helped to create—and with union leaders who cosy up to it. A “summer of discontent” is unlikely; but it may prove an inglorious one for Mr Blair.

What has Tony ever done for us?

He is entitled to be perplexed. As David Metcalf, of the London School of Economics (LSE), says, Labour has delivered “as good a tranche of pro-employee legislation as there has been in a generation or longer”. Union leaders (as is their job) want more; but, for instance, the government has already given them a minimum wage and new recognition rights.

Mr Blair's style is part of the explanation. Union leaders don't like the company he keeps in Europe; and they don't appreciate the public insults he occasionally flings their way. Several have responded by cutting their contributions to the Labour Party, which, combined with declining membership and an election spending binge, has left it £6m ($9.4m) in the red.

But Labour's difficulties with the unions are also a product of its success. Just as Labour continued to behave like an opposition after it was elected, so the unions, equally scarred by the many Tory years, trod carefully during Labour's first term. Now, after a second Labour landslide, and with little opposition to speak of, the gloves are coming off.

And after last week's spending review—in which Gordon Brown, the chancellor, pledged to raise public expenditure by £93 billion over three years—so have the hair-shirts. The public-sector unions (as is their job) want some of that cash; the council workers, for instance, are demanding a 6% pay rise. Some of them are indeed stingily remunerated. In other parts of the public sector, the government will have to spend some cash to recruit and retain workers. But Mr Brown is understandably keen to dispel the notion that all that tax revenue is simply being passed on to public servants, in exchange for little.

Unfortunately for the government, in a tight labour market the workers don't feel obliged to ask nicely. And one of the things ministers want in return for the extra cash—more private involvement in public services—is particularly unpopular with the unions, who worry about the terms and conditions of workers transferred to private contractors. The differences may not be irreconcilable: on July 23rd, the government came up with a placatory formula for transferred local government employees; and Unison, a giant public-sector union, approved government plans for staff arrangements in hospitals run under the private-finance initiative. But the privatisation of public services could still bring Mr Blair to grief.

The undead

That's partly because of the profile of union membership. After shedding around 5m members in 20 years, as labour laws and economic restructuring shrunk the unions' power and industrial base, membership, though ageing, has stabilised. But the unions' stronghold, inconveniently for the government, is the public sector (see chart on previous page). That may also be one reason why the unions want public servants to remain public.

Strikes aren't in the long-term interest of the unions. As Mr Metcalf, of the LSE, says, militancy is unlikely to impress either prospective members, or employers considering a recognition deal. But, along with obstreperous delays to reform, strikes will damage a government which, perhaps unwisely, has gambled its future on its ability to improve public services. If Britain is unlikely to revisit the mythologised days of 1979, when, legend has it, the dead lay unburied, neither are the unions themselves dead and buried.

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Sociology

Subtract rows, add sex

Jul 25th 2002
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"Happiness economics" has arrived. Will public policy be the same again?

WHO is the happiest person in Britain? According to one recent study, she is educated, married, well-off and retired. In another, she is Scottish, and unlikely to live in London. To judge by a third, her averagely happy friends are glummer than their counterparts in Denmark, Australia and the United States. The happiest person in America is not a woman.

Happiness surveys have been around for some time, and not everyone takes them seriously. One academic study famously concluded that marital satisfaction could be predicted by the frequency of intercourse minus the number of rows. But in the past few years, economists have arrived on the scene; and Andrew Oswald, professor of economics at Warwick University, thinks happiness economics could revolutionise public policy.

Take the idea that money can buy happiness. Wrong, say researchers. Although income makes a difference, other factors—notably health and love—make more. And although Britain is nearly three times richer than it was half a century ago, overall well-being levels have hardly budged. That, says Professor Oswald, should encourage the government to look beyond GDP as a measure of quality of life.

More controversially, Professor Oswald's group has come up with a way of putting values on "life events". On average, he says, getting married brings the same amount of happiness as about £60,000 ($90,000) a year in income. The loss of well-being caused by widowhood would take £170,000 a year to offset. Unemployment brings psychological costs equivalent to much more than the average drop in income, if you live in a place with few jobs and want to work.

Some of Professor Oswald's colleagues think all this is pie in the sky. They point out that happiness is subjective, and that happier people may simply be more likely to get on in life. Researchers reply that their samples are large enough to average out individual answers, and that measuring the benefit that, say, marriage brings deals with variations in temperament.

Even so, different surveys can produce wildly different results. While most find that education equals increased happiness, one suggests that British graduates have lower life-satisfaction ratings than other workers. And comparisons between countries can throw up some outlandish figures: one substantial survey found that Danes are five times happier than Italians.

Professor Oswald thinks these problems can be ironed out with more detailed research. And in 20 years' time, he predicts, his figures will be common currency. He can already see plenty of practical applications. Divorce lawyers, for instance, might be interested to know the true cost of infidelity. That should be enough to make many people's happiness-levels plummet.

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Agriculture

Learning the hard way

Jul 25th 2002 | SETTLE, NORTH YORKSHIRE
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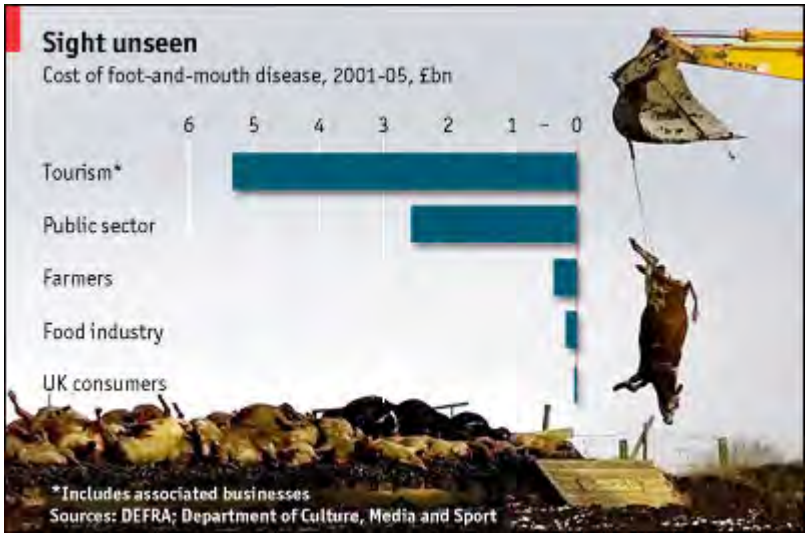
AP



The failure to learn the lessons of the past turned last year's foot-and-mouth epidemic into one of Britain's worst peacetime disasters

Get article background

SINCE Britain was declared free of foot-and-mouth disease six months ago, the town of Settle in the Yorkshire Dales has scarcely lived up to its name. Last year the local economy, dependent largely on tourism, was badly hit by the outbreak, which led to the closure of footpaths, a halt on animal movements and piles of slaughtered livestock. The town's outdoor travel store, Cave and Crag, saw its earnings fall by 60% from the previous year.

Settle, however, is now once again bustling with activity and the ramblers are back in force. The disease has proved, says Angela Campbell, one of the planners on the town's new business development scheme, a useful catalyst for change that was long overdue.

All eyes are now on government to see if it will also learn from its mistakes. The foot-and-mouth epidemic was one of the worst peacetime disasters since 1945: the outbreak lasted 221 days, led to the slaughter of at least 6.5m sheep, pigs and cows and cost the country £8 billion. The government has been widely blamed for mishandling the crisis. On July 22nd, the last of three official investigations into the mess, the “Lessons to Be Learned” inquiry led by Iain Anderson, a former special adviser to Tony Blair, gave its verdict.

Mr Anderson is keener on reforming procedures than blaming individuals. There is plenty of scope for improvement. The old Ministry of Agriculture, Fisheries and Food (MAFF) is criticised for being far too slow in responding and for underestimating how much needed to be done. MAFF waited four days from the moment foot-and-mouth was suspected in an abattoir in Essex in February 2001 before ordering a halt to all animal movements, which made later control more difficult. As the disease spread there were further long delays in getting animals to slaughter and disposing of carcasses either by burning or burial.

MAFF failed to make the most of local know-how, had inadequate information-gathering and management systems, and did a poor job at communicating its decisions to farmers. It was not until the Cabinet Office took over in March, and the army was called in, that the plague was brought under

control.

Why was this not done sooner? Mr Anderson says he can find no evidence of political meddling in the way the crisis was handled, beyond the usual pre-election preoccupations of politicians. What does frustrate him, however, are the hazy accounts of how key decisions—for example, closing footpaths or the swift cull of seemingly uninfected animals on neighbouring farms—were made. It seems that the origin of these controversial moves, like the way the disease came to Britain in the first place, will remain a mystery.

Along with calls for better record-keeping, stronger disease surveillance, boosting the country's veterinary resources, and tighter controls on illegal food imports, Mr Anderson's findings largely echo the Royal Society's inquiry into the technical aspects of controlling infectious diseases in livestock, published last week. Controversially, it called for emergency vaccination as an integral part of any future strategy. During the British outbreak, the National Farmers' Union fiercely resisted this course, in part because it feared that retailers would refuse to sell meat from vaccinated animals. But Sir Brian Follett, head of the Royal Society's inquiry, says that his team was unable to substantiate such resistance by supermarkets. In any case, most meat on shop shelves already comes from animals which have been vaccinated against one disease or another.

Historically, vaccination has also hampered trade, because blood tests used to detect infections in animals also pick up vaccinated animals as false positives, and both are excluded by international authorities for export. However, more sophisticated vaccines, and better diagnostic tests, are now being developed and should, with time, help to remove this obstacle. Ultimately, says Sir Brian, more money and manpower should be devoted to coming up with a new vaccine which could be used to protect animals long before an outbreak starts.

Sir Brian also wants to see a regularly revised contingency plan for dealing with various infectious animal diseases, to be given equal priority as other civil emergencies such as bio-terrorist attack. The Netherlands already has such an arrangement, which meant that it stopped animal shipments two days before Britain did, and helped it to contain the outbreak when it spread to its country.

Whether such lessons will be acted upon remains to be seen. Margaret Beckett, in charge of the restructured agriculture ministry, admits that mistakes were made, but insists this is largely the benefit of hindsight. That ignores the fact that important lessons from previous inquiries could have been followed, but were not. For example, some recommendations from the last outbreak in Britain, in 1967, such as better planning before an outbreak, were not implemented. Even lessons from more recent inquiries, such as the Phillips report into BSE, which suggested changes to the way government ministries communicate with one another and the public, appear to have been ignored. Although the government is now promising change, the record of those who run British agriculture does not inspire confidence.

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Airports

Bad faith

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From The Economist print edition

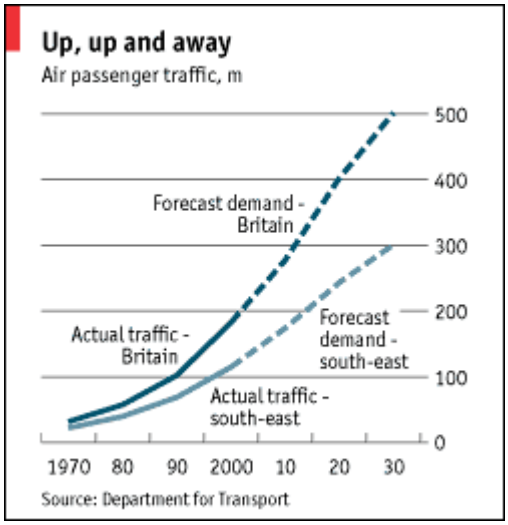
Decisions on new runways are made no easier by a total absence of trust

LESS than a year ago, the government said that it would restrict flights at London's Heathrow airport as a condition of its approval of a fifth airport terminal. On July 23rd, the publication of a consultation document on new airport capacity suggested that commitment has been scrapped. One of the key options in the paper is for a new runway at Heathrow, which would increase its capacity by more than a third.

A principal recommendation of an inquiry into that fifth terminal—that flights at Heathrow should be capped at 480,000 a year—has been ignored. So has the conclusion of the planning inspector, Roy Vandermeer, that a new runway at Heathrow would have "such severe and widespread impacts on the environment as to be totally unacceptable."

On airport policy, history appears condemned to repeat itself. A quarter of a century ago, at the public inquiry into a fourth terminal at Heathrow, the planning inspector, Ian Glidewell, approved its development on condition that this would be the last expansion at the airport. This he guaranteed by setting a cap of 250,000 flights a year. That condition was also rapidly junked as too restrictive.

This record of broken promises makes for distrust. Yet ministers are right to point out that new runways are urgently needed. None has been built in the south-east for the past half-century. Heathrow's two runways are already full for most hours of the day, and delays are worsening. If passenger demand cannot be met, fares will have to rise sharply—by at least £100 per person in today's prices, according to the consultation document. The impact on economic competitiveness could be severe. Heathrow has half the number of runways of continental rivals such as Amsterdam's Schiphol or Paris's Charles de Gaulle. Those airports are well-placed to cope with the predicted trebling of passenger traffic over the next 30 years—at Britain's expense (see chart).



But that leaves open the question of where new airports should be sited. The consultation document puts the main choices fairly. The easiest short-term option is probably the construction of new runways at Stansted, turning it into a super-hub airport serving all of London. The most radical option (costing at least £20 billion, with transport links) would be to construct a new airport at Cliffe, on the north Kent coast of the Thames estuary.

If these are rejected, that leaves only the further expansion of Heathrow, already the world's busiest international airport. Quite apart from the destruction of several hundred houses and listed buildings, a new runway would expose more than 100,000 people to a lot more aircraft noise, and 30,000 to nitrogen-dioxide levels exceeding EU limits.

Development of Heathrow may be the cheap option, but no one in their right mind today would build an airport whose flight-path is over a capital city. If ministers go down this route, they can expect violent protests. The option of a new 24-hour airport sited on the Thames estuary with 30-minute rail connections to the centre of London has many advantages, despite the damage it would do to a wildlife site. It should be carefully considered. Birds matter, but they can fly away more easily than humans.

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About sponsorship

The Archbishop of Canterbury

His own man

Jul 25th 2002
From The Economist print edition

Rowan Williams is already causing tremors. So he should

PA

Not cuddly

ARCHBISHOPS of Canterbury are not always cuddly creatures. Ask Henry II, who in the 1160s had a famous falling-out about taxes with Thomas Becket and in the end, barefoot and abject, had to admit defeat. The Reformation made things easier, allowing kings and queens to choose their own archbishops rather than sending sugary requests to Rome. Yet even the last half of the 20th century—which saw the Church of England reduced to clusters of old ladies in cavernously empty churches—still produced, in Robert Runcie and George Carey, well-mannered prickles of dissent from the government of the day, and in Michael Ramsay a leader of blunt opinions as well as spiritual strength.

Rowan Williams, confirmed on July 23rd to Canterbury after months of murmurs, promises to be in the Ramsay mould. He has a fierce and broad intelligence, and means to use it whether Tony Blair, who picked him, likes it or not. He has already condemned the war in Afghanistan ("morally tainted"), and only last week, with Canterbury's towers already in view, he added his name to a declaration that plans to attack Iraq were "immoral and illegal". The man who was arrested two decades ago on a demonstration outside an American air-force base will not be backing down because he wears the primate's mitre.

Where Dr Williams may have to tread more carefully—but probably won't—is in matters concerning the church he now governs. The Anglican communion, with 70m souls from Canada to Africa, is a creature almost as heterogeneous as ex-rival Rome, but without the slap of dogma to keep it in line. Dr Williams's readiness to ordain active homosexuals has infuriated evangelicals and conservatives in many countries. At home, his readiness—as an archbishop of the disestablished Church of Wales—to disestablish the Church of England, thereby removing the crust of ceremony that just about sustains it, has caused many teacups to tremble.

Religious leaders are, however, meant to raise awkward questions and say hard things. The most difficult of all, these days, is to state the Christian doctrine of incarnation, resurrection and salvation. Dr Williams, the youngest Archbishop of Canterbury for many years, is as orthodox on those matters—the fundamental point of his job—as he is "liberal" on gays and Iraq. For that, his church should be grateful.

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Food deserts

Getting stuffed

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Finding healthy and affordable food can be harder than you might think

CROSSING a food desert isn't like traversing the Gobi or the Ténéré. It's like crossing an army-training obstacle course. Just try getting from the Cranberry estate in Newham, east London, to the nearest Kwik Save mini-mart. The 15-minute trip involves clambering over wheelie bins, scaling a high brick wall, squeezing between the bars of spike-tipped fences, dodging flying soccer balls in a school playground and navigating a neighbouring estate. And that's the shortcut. Walking the long way round takes a good half-hour. The closest supermarket is several miles away, in Stratford.

The term “food desert” was coined to describe areas with limited access to healthy food. There are food deserts all over Britain, in rural as well as urban areas. “It's not just a matter of there being no shops,” says Elizabeth Dowler, a sociologist at Warwick University. “Often there are shops. But these tend to be meagre, run-down shops which sell little or no fresh food.” A recent study of Sandwell, West Bromwich, for instance, found that around 90% of the households in the area were within 500 metres of shops that sold junk food and fizzy drinks. Less than 20% of the houses were within 500 metres of a shop selling fresh fruit and vegetables.

This can be attributed largely to the steady increase in the number of supermarkets in Britain since the 1970s and the commensurate decline in the number of independent grocers. Around 80% of food shopping is now done in supermarkets, compared with less than 50% 25 years ago. The few independent grocers who remain in poorer areas must also live with the threat of violence and vandalism.

Increasingly, supermarkets are moving out of inner-city areas to the suburbs, where there is more space and better access to main roads, in order to facilitate their high-speed, high-volume turnover. That is bad luck for anyone who doesn't own a car or live on a bus route. For the elderly, the disabled or single parents with small children, such physical obstacles to affordable food can seem insurmountable.

The problem of access is compounded by economics. According to a report published last year by the Child Poverty Action Group, spending on food in poor families is often cut to avoid debt or to meet other essential payments such as gas, electricity or rent.

Sally Cavanagh of Sustain, a food charity, highlights a further problem: healthy foods are more expensive than nutritionally poor alternatives. “The price gap was about 20% in the late 1980s,” she says. “It had risen to about 40% by the mid-1990s. It's now over 50%.” This “health premium” is greater in supermarkets in poor areas. And though some supermarkets are starting to discount fruit and vegetables, “economy” lines are still dominated by fatty, sugary and salty foods.

Meanwhile, Britain has one of the highest death rates for coronary heart disease in Western Europe, and a third of all cancers are diet-related. Treating heart disease costs the NHS £2.4 billion a year and some £10 billion in lost productivity.

Some people are trying to offer the poor the choices the market is denying them. Eric Samuel, co-ordinator of the Newham Food Access Partnership, gets up at half past three in the morning six days a week and sets off for Spitalfields market to buy fresh fruit and vegetables. Much of the produce goes to breakfast clubs and tuck shops in 20 of the borough's primary schools. Schools, Mr Samuel says, are great places to operate such markets, since mothers have to go there anyway to pick up their kids. Mr Samuel is justifiably proud of his success, though he admits the early mornings are a bummer. “But you've got to start somewhere.”

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Housing

Transfer or be damned

Jul 25th 2002
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Council tenants do not always vote in their own interests

PA

Every vote counts

“OCEAN is not for sale,” shout the red graffiti on the wall. The Ocean estate in Stepney, built in the 1950s, is home to 6,500 people, most of whom are Bengali immigrants. Overcrowded and crime-ridden, it is one of London's most deprived council estates. Many of its buildings are subsiding, the local authority has been unable to keep up with repairs, and residents have grown tired of complaining about mould on walls, leaking roofs and stairwells inhabited by drug dealers.

Tower Hamlets council, whose housing revenue account will soon be £500m in deficit, is desperate to get the problem off its books. It wants to transfer ownership of the estate to a housing association, which would then redevelop it, using its ability to borrow money against future rents. But this can happen only if residents vote in favour. And as the graffiti indicate, many on the estate oppose transfer. “We are being stitched up like a kipper,” says Brenda Daley, the chairwoman of Ocean's tenants and leaseholders' association.

This is not the first such row. Since 1988, more than 120 local authorities have handed over 600,000 council properties, valued at £5 billion, to housing associations. It has been one of the more successful examples of public-private partnership. Local authorities have not proved good landlords of mass social housing. Yet transfers have not always gone smoothly. Earlier this year, Birmingham's council tenants rejected by a two-thirds majority the option to change tenure, leaving the city with a £1 billion hole in urgently needed housing investment.

In Stepney, the argument is complicated by history. In 1986, the residents rejected plans for modernisation of the estate. Shahab Uddin, chairman of Ocean's New Deal for Communities board, who led that fight, is now a reluctant advocate of transfer. “I am hopeful that the people will accept,” he says. The board's adviser, Ken Bartlett, chairman of Stepney Housing and Development Agency, is more cautious, noting that the scheme's complexity leaves it open to misrepresentation.

There are other hurdles. Council tenants are entitled to purchase their houses at £38,000 less than the market value, twice the discount available to a housing-association tenant. The minority who hope to make large capital sums by buying their flats are not keen on transfer. Older residents fear the inevitable disruption that development would bring. Fear of the unknown is powerful. The new landlords, some worry, would put up rents. Overcoming this suspicion is not easy, even when the crumbling legacy of council control is visible at every corner.

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Bagehot

Pork on the menu

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From The Economist print edition

Devolution was meant to revitalise Scottish politics. Three years on the Scots are still waiting

AND so to Edinburgh. Hoping to escape, however briefly, from the confines of the Westminster “bubble”, Bagehot ventured north to celebrate with proud Scots the third anniversary of their brave new Parliament at Holyrood. Here, perhaps, would be found an optimistic new politics that would stand in bright contrast to the wearying games being played out in London. Well, yes and no. Politics north of the border is different all right, and becoming increasingly so. But that may be the best that can be said for it.

As good a starting place as any to understand its distinctiveness is with the Liberal Democrats, partners with Labour both in the project that led to devolution and, from the outset, in the new executive that governs Scotland. The Lib Dems are rather chipper about their role in the ruling coalition, having forced the Labour-led executive to spend more money than it would otherwise have done. Thanks to their efforts, Scottish university students, unlike their English counterparts, don't have to pay up-front tuition fees. And from this month, again in contrast to England, many elderly Scots will qualify for free home care.

But with parliamentary elections due next May, there is already speculation that the coalition will not last. Maybe, maybe not, says one Lib Dem MSP; it will depend on the results and the outcome of some very tough negotiations. Negotiations on some major issues of principle? “Er, no, not exactly.” On what then? “Well, on pork. What we want is more money spent on the things we want in the places we want. It's pure pork-barrel politics. We might as well be honest about it.”

Nor are the Lib Dems alone. The Scottish Nationalists (SNP), the second biggest party at Holyrood, are also dedicated spenders, while the poor old Tories, without a single constituency MP in the parliament (MSPs are divided into those who are directly elected to represent constituencies and others who are voted in because they're on party lists), are so desperate to be loved that they'll put their hands up for anything popular. Supporters of the parliament claim that it quietly gets on with a good deal of useful work, but that's not the stuff that hits the headlines.

The colossal overrun in the cost of building the parliament—the final bill will be well in excess of £300m ($450m), eight times an original estimate of £40m—hasn't helped, but nor have the politicians. Apart from tuition fees and home care, MSPs also voted a few months ago to give themselves a 13.5% pay rise. Other votes have included the abolition of Section 28 of the Local Government Act, which forbids “the promotion of homosexuality” in schools, and a sloppily drafted ban on hunting with dogs. A silly rule limiting speeches to four minutes and a clocking-off time of 5 pm have resulted in a lifeless debating chamber.

Meanwhile, the executive has proposed making it illegal to smack children under three and has rewarded its chums in the teaching unions with a 35-hour week linked to a 21.5% pay increase over three years, since when teacher productivity has gone steadily downhill. Public-sector employment is rising rapidly, as is the cost of the executive itself, which has increased by 44% since 1999. As one Scottish and very-New-Labour MP at Westminster admitted ruefully: “It's basically old-style municipal socialism with an overlay of political correctness.”

Fortunately, there is plenty of money slopping around to pay for all this. Scotland already receives, thanks to the “Barnett Formula”, a subsidy from Westminster that controversially funds a level of public spending 23% higher per head than in England. As long as that lasts, and Gordon Brown's gusher from London continues to flow, the Scottish Parliament may not even have to worry about raising taxes by the paltry 3p it is permitted. But it's hardly a recipe for fiscal responsibility.

Mickey rules, OK

For all the bright talk about the dynamising affects of devolution, the truth is that the transfer of powers to Edinburgh has been too limited to produce any other kind of politics. Neither the executive nor the parliament display any interest in the performance of the wealth-creating sector or in doing anything to reverse Scotland's long-run economic decline relative to Britain as a whole. But even if it were otherwise, they lack the policy tools to do anything useful. As a big cheese in one of Edinburgh's successful financial-services firms said contemptuously: “We have a Mickey Mouse parliament run by Lanarkshire councillors. Such people don't like straying far from their comfort zones. The best they can do is get out of our way.”

The frustrations of the devolution settlement were one reason for the resignation from the executive in May of Wendy Alexander, a protégé of Gordon Brown's and, by most reckonings, the only member of the executive with any star quality. Another was a fairly poisonous relationship with the new first minister, Jack McConnell, who, having succeeded the disgraced Henry McLeish last year, has done more to reward loyalty than competence. Ms Alexander was interested in Scotland's economic underperformance, but belatedly realised she was in the wrong place to do anything about it. So too is the SNP's bright young economics spokesman, Andrew Wilson. Mr Wilson dreams of following the example of Ireland, creating a business-friendly climate by cutting taxes on companies and encouraging investment. Unfortunately, his left-leaning party is increasingly intent on marginalising him.

Although it is still early days, it's hard to see a more grown-up politics emerging. Opinion polls suggest that while few Scots want to turn the clock back to pre-devolution days, there is no clamour to give their mildly despised new Parliament significant additional powers. And full-blown independence remains a minority taste. It's no wonder that the politicians who are thriving are parochial pragmatists, happy to play on the court as it has been marked out by Westminster.

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Corporate culture

When something is rotten

Jul 25th 2002
From The Economist print edition

The best defence against "infectious greed" is a healthy corporate culture

WHEN WorldCom revealed in June that it had fiddled its accounts to the tune of $3.9 billion in the 15 months to the end of March, it was the tip of an iceberg. Employees have since alleged that the practice had been going on for much longer. Moreover, malpractice was not confined to the accounts department. WorldCom's sales staff were also fiddling the figures. In February three WorldCom salesmen at the company's Arlington, Virginia, office were suspended in a case involving millions of dollars of overpaid commissions. The company's Chicago and Baltimore offices were investigated at the same time.

Former employees say that a practice known as "rolling revenue" was endemic in the sales hierarchy of WorldCom. The practice involved registering a single sale many times over, even if it meant paying salesmen several commissions in the process. At WorldCom, which filed for Chapter 11 bankruptcy this week (see article), increasing reported revenues came above all else.

It is a pattern repeated elsewhere. When James Bingham, an assistant treasurer at Xerox, first blew the whistle on the photocopier company's accounting tricks in 2000, he admitted that he had initially been an enthusiastic participant in a charade that led the group to overstate its profits by $1.4 billion between 1997 and 2001. "Sometimes I fed the beast," he said. "The beast was a Xerox culture that created an illusion of value."

Early this month Xerox admitted in a regulatory filing that, in an effort to push sales at its Indian unit, it had made "improper payments over a period of years" to government officials there. In 2000, when the bribery is said to have stopped, payments amounted to "approximately $600,000-700,000". Xerox is also investigating allegations that transactions by its South African affiliate were "improperly recorded" and that a South American division made "improper payments".

Last week Alan Greenspan, chairman of America's Federal Reserve, spoke of the "infectious greed" that had gripped much of American business, a greed that ultimately pushed companies such as Enron, Global Crossing and now WorldCom into bankruptcy. Greed is not the only infection that can grip a corporation. If, in the 1990s, Arthur Andersen (auditor of Enron, Global Crossing and WorldCom) had been less envious of the high-rolling consultants at its former twin, now called Accenture, and had not gone chasing blindly after their business, it might now have a future beyond the end of next month, when it is to cease operations.

Infections spread via an organisation's culture—meaning the set of rites and rituals, symbols and signals

that give it its unique character. Culture is the “way things are done around here”—the HP Way, for example, the open-plan, walkabout management style laid down in the 1950s by Bill Hewlett and Dave Packard, a style that still imbues the company today. But culture is a concept that many business leaders find difficult to grasp. They consider it too soft to be managed—even though its importance is more appreciated now than it was when one executive some years ago asserted that “the only culture round here is in the yoghurts in the canteen”.

Good for more than the yoghurt

“A corporation's culture is what determines how people behave when they are not being watched,” says Tom Tierney, a former managing partner of Bain, a consultancy, and author of “Aligning the Stars”, a book about the culture of professional-service firms. Cultures are formed over time, by big events and small ones. The $110 billion merger of AOL and Time Warner has tried, so far disastrously, to weld a nifty e-culture to a sedate media business. The departure of Bob Pittman, the group's chief operating officer and an AOL man, marks a return to dominance by the old-media culture (see article).

At the best companies, the way managers interact helps to set the tone. The culture of Jack Welch's General Electric was forged to a large extent by what have been described as something “close to revivalist prayer meetings”, gruelling question-and-answer sessions with managers at the company's training centre in upstate New York. Wal-Mart's culture of penny-pinching zealotry is reinforced by the company's weekly Saturday morning meetings for managers and their families—part evangelical revival, part corporate Oscars.

Cultures are influenced by the sort of people a company recruits. Enron had a policy of recruiting fast-track MBA“talent” into the culture of an electric utility. It didn't work, and the firm ended up promoting the pushy over the prudent. But the biggest single influence on a culture is the company's boss. Lawrence Weinbach, head of Unisys, an IT-services firm, told a recent meeting of leading American chief executives: “Once you as CEO go over the line, then people think it's okay to go over the line themselves.” Employees set their behaviour by the pole star at the top. If they have been disoriented in recent years, it is partly because there has been an unprecedented turnover in bosses.

“Once you as CEO go over the line, then people think it's okay to go over the line themselves”

First came the boom in mergers (which inevitably throw one of the merging companies' bosses out of the top chair). Many of America's downfallen (Tyco, Global Crossing, WorldCom) were hastily bundled together amalgamations of companies that lost their distinctive ways and found nothing to replace them. Then came the dotcom bust, which forced many chief executives to fall on their swords. Now, says Challenger, Gray & Christmas, a headhunter, “we are seeing CEOs leaving under a cloud of suspected or substantiated wrongdoing.”

All this is unhelpful to the growth of a healthy culture, “the key to which is consistency,” says Dominic Dodd of Marakon, a consultancy that has advised some of the world's most consistently successful companies, including Boeing, Dow Chemical and Lloyds TSB. One recommended aid to consistency is “the broken record”, the mantra repeated over and over again by the boss. Sir Richard Branson, the unconventional head of Britain's Virgin group, has a few such phrases; one is, “common sense counts for way more than pure intellect.” A favourite saying at Cadbury Schweppes is “the tyranny of ‘or' and the beauty of ‘and'.” Easily remembered, phrases like these set the tone for an entire organisation's behaviour. But, says Mr Dodd, bosses need to know when to change the record. Jack Welch, he believes, was a master at that.

Drug culture

Mergers and a change of chief executive do not necessarily cause a culture to rot. Look at Aventis. Created in 1999 by the merger of two chemicals companies—Germany's Hoechst and France's Rhône-Poulenc—it not only integrated two firms of different nationalities, each with over a century of its own traditions, but also transformed the industries they were in. Since 1999 Aventis has moved to being a pure pharmaceuticals firm. It set up a new head office in Strasbourg (historically tossed between French and German rulers) and it relocated its three inherited American HQs to one base in New Jersey.

At the core of its cultural change was an unusually close relationship between the company's two heads: Jürgen Dormann from Hoechst and Jean-René Fourtou from Rhône-Poulenc. Their rallying cry—“we want

to create something new”—seems to have had the desired effect on the group's 75,000 employees: Aventis's earnings per share are growing by some 40% a year, and its sales by 12-15%.

It is no surprise that Mr Fourtou was picked to replace Jean-Marie Messier, the disgraced boss of Vivendi, a Franco-American cultural and commercial disaster. When your culture is putrid, recruiting a chief executive from outside is not a bad idea. Challenger, Gray & Christmas says the biggest challenge facing corporate America is “finding replacement CEOs who are above reproach yet still able to lead companies back from the depths.”

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Telecoms

The only way is up, maybe

Jul 25th 2002
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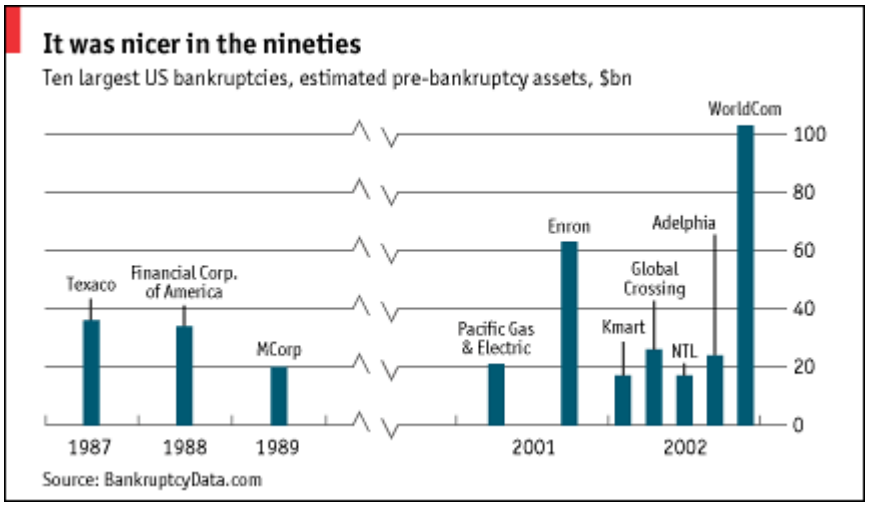
WorldCom's bankruptcy may mark the low point for the telecoms industry

Get article background

MIGHT this be remembered as the week when the shattered telecoms industry started to pick itself up off the floor? It seems an odd question to ask only a few days after WorldCom, a disgraced American operator with over $100 billion of assets on its books, became the largest American company ever to file for bankruptcy (see chart). Other telecoms companies also reported bad news: AT&T, a rival long-haul operator, announced a $12.7 billion quarterly loss; Lucent, an equipment vendor, a $7.9 billion loss and 7,000 new job cuts; and BellSouth, a regional operator, said that its earnings would fall far short of expectations. But amid the carnage, there were faint signs that an end to the industry's woes could be in sight.



Announcing his firm's bankruptcy filing on July 22nd, WorldCom's chief executive, John Sidgmore, gamely tried to present it as good news, on the grounds that it would reduce uncertainty and stabilise the situation. His plan is to sell some assets—probably starting with MCI, WorldCom's long-distance phone business, and SkyTel, its paging unit—and to refocus the company around UUNET, its Internet-backbone operation, which carries over half of America's Internet traffic.

WorldCom plans to appoint a “chief restructuring officer” within three weeks, and to emerge from bankruptcy protection within a year. But not everybody is convinced that the company can survive. A report from Gartner, a consultancy, puts WorldCom's chances of avoiding liquidation at 60%, and suggests that even then, the firm would probably be taken over.

The behaviour of WorldCom's customers will be crucial. Neil Rickard of Gartner says his firm has been advising its clients to avoid knee-jerk reactions. Customers who jump too quickly to a different operator, he warns, could face penalties for breach of contract. And by rushing into the arms of another operator without carefully considering all the options, they may end up paying over the odds. Instead, says Mr Rickard, WorldCom customers should take a more measured approach, switching only new business to a different operator, but making contingency plans for a complete switch-over just in case.

Two carriers that claim to be picking up customers from WorldCom are AT&T and Equant. Indeed, AT&T seems to be overwhelmed with potential customers, says David Willis of Meta Group, a consultancy.

Some of his clients have complained that AT&T is not responding to their inquiries fast enough. For his part, Didier Delepine, chief executive of Equant, says his firm has 130 big WorldCom customers "knocking at the door", seven of whom have already switched. Equant has made preparations to make possible speedy connections for any WorldCom customers who want to be able to switch at short notice.

All of this suggests that WorldCom will bleed, but only slowly, as expiring contracts are not renewed and new business goes elsewhere. Mr Sidgmore insists there is no "exodus" taking place. But Mr Willis estimates that big companies are switching about 10% of their WorldCom business to other operators, and will have switched 20% within six months. The chief beneficiaries will be former monopoly operators in Europe and the "Baby Bell" regional operators in America, plus a handful of other carriers, including AT&T, Equant, Cable & Wireless and Infonet.

These firms are seen as relatively safe bets by large companies, and can therefore charge premium rates. "The days of bargain-basement communications are almost over," says Mr Willis. As the industry prepares for a round of mergers, he suggests that firms that sign new contracts with telecoms operators should be asking: "Are you making money on this?" If the operator is taken over, he notes, "you want to have a contract that an acquiring company would want to have."

"The days of bargain-basement communications are almost over"

The prospect of rising prices is not the only signal that the market could be about to turn. This week it emerged that, in the three months to June 30th, executives at American telecoms firms bought more of their companies' shares than they sold. (Across American firms in general, sales exceeded purchases by 15 to one.) With shares in many firms having fallen by over 99%, this looks like speculative buying in advance of an expected wave of acquisitions over the next year or so.

Another hopeful sign was the $1.1 billion bid by Level 3, a long-distance-network operator, for Williams Communications, a bankrupt operator that is now restructuring its debts. A consortium of investors including Warren Buffett, a long-time telecoms sceptic, recently announced an investment of $500m in Level 3, which said it would use the money to finance acquisitions. A takeover of Williams could, says Mr Rickard, constitute "the first glimmer of the consolidation phase". And that, in turn, would mark the beginning of what is sure to be a long and painful turnaround for the industry.

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AOL Time Warner

Dotcom downsizing

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The shake-up at AOL Time Warner has put the Internet in its place

Get article background

AP

Pittman couldn't get a grip on AOL

WHEN America Online and Time Warner announced their merger in January 2000, at the height of the Internet boom, this mega-marriage of new technology and old media was enthusiastically received. The world's biggest online service was expected to inject its “Internet DNA” into the stodgy media giant. Together they would come up with all sorts of lucrative synergies and “cross-fertilisation”. Even *The Economist* was excited: “For once, the superlatives and the hype seem justified,” we opined.

How wrong we were—as, it must be said, was almost everybody else. On July 18th Bob Pittman, the company's chief operating officer and the merger's biggest cheerleader, resigned, having failed to turn round troubled AOL. Time Warner veterans are now firmly in control of the media conglomerate. Don Logan, the former chairman of its magazine group, will now oversee AOL as one of two “group chairmen”. Attempts to create synergies, mostly ill-fated so far, are no longer a priority. The group's divisions can again more or less mind their own business, just as at the old Time Warner.

Like its big media rivals, AOL Time Warner has been clobbered by the weakness of the advertising market. On July 24th the company reported that advertising revenues in the second quarter were down by 11%, to $2.1 billion, with AOL's ad revenues falling 42%—though overall revenues were 10% higher at $10.6 billion and the group was able to book its first quarterly net profit since completing the merger.

Inevitably, there are also questions over AOL Time Warner's accounting. Shortly before Mr Pittman's resignation, investors had begun to worry that the company might be guilty of pulling a WorldCom, shifting everyday expenses to capital accounts. Newspapers, led by the *Washington Post*, began chronicling the creative ways in which AOL had accounted for some advertising deals. On July 24th the company disclosed that the SEC was looking into its accounting practices.

So far, though, there is no evidence that AOL Time Warner's accounting was unusually aggressive. Nor does the group seem to face a financial crunch à la Vivendi, a Franco-American media rival. Its main problems, for now, are more operational in nature. The most immediate challenge for the new management team is to calm the waters internally. Many Time Warner veterans are still angry at the AOL newcomers, holding them responsible for a fall in the share price of more than 75% since the merger. Conversely, AOL employees may not appreciate being ordered around by old-media types. Much will depend on whom the firm picks as AOL's new chief executive, a job that Mr Pittman had taken over temporarily.

The new boss will have his work cut out. AOL has suffered from the advertising slowdown more than the group's other units, mainly because most of its clients were dotcoms. Worse, subscriber growth has slowed. In the past two years, AOL's share of the American Internet-access market has slipped from 41% to 37%, according to Odyssey, a research company.

Furthermore, AOL is having trouble negotiating the shift from dial-up to broadband connections. It has only a 5% share in broadband, in part because it has an interest in not moving its customers too quickly: AOL makes $10 profit a month from the average dial-up customer, but less than half that from

broadband customers. Yet this leaves an opening for competitors. Microsoft, in particular, is investing serious money to get broadband distribution for its MSN online service.

If AOL's new boss cannot turn things round, it may be spun off. But even if the new leader succeeds, AOL will remain several pegs below where it was just after the merger; from now on, it will be merely a part of a big media group. The management shake-up has put the Internet in its place. Rather than turning the world on its head, the web is turning out to be only an extra distribution and marketing channel. With the hype and superlatives now gone, the merger—and the search for synergies—can begin in earnest.

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Business schools

The $100,000 question

Jul 25th 2002
From The Economist print edition

Do you really need that MBA?

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EVERY year another 100,000 or so MBAs pour on to the American job market. If they have done a full-time two-year course at one of the top schools, they will have spent as much as $100,000 to get their degree. They may end up in illustrious careers: even George Bush is a Harvard MBA. But will that be thanks to what they have been taught? Not if a new study (by Jeffrey Pfeffer, a professor at Stanford's business school, Harvard's great rival) is right.

In academic terms the MBA, invented in America in 1908, has been a success story. Demand has soared, and not only in the United States. According to a survey by the Institute for International Education, 14.4% of MBA students studying in America in autumn 2000 were from abroad. Even German MBA programmes are gaining in popularity, albeit slowly (see article). But Mr Pfeffer and his co-author, Christina Fong, writing in the first issue of a new journal, *Academy of Management Learning and Education*, argue that there is little evidence that getting an MBA has much effect on a graduate's salary or career.

Hunting through 40 years of studies, in search of a link between MBA results and future salary, Mr Pfeffer was struck by this lack of evidence. He cites internal studies by consulting firms and investment banks—two prime employers of MBAs—that suggest that non-MBAs do no worse than their more qualified colleagues. “Usually it just makes you a couple of years older than non-MBA peers,” the author of one such study told him.

Of course, as Mr Pfeffer admits, the course content may not be the only reason for getting an MBA. A top business school plugs students into an invaluable network of contacts. It also screens them. Charles O'Reilly, one of Mr Pfeffer's colleagues at Stanford, points out that MBA students at a top school are “smart, ambitious, willing to make sacrifices and keen to play the corporate game.” That makes it a good place for firms to recruit.

Recruitment for MBA courses is booming—after all, enrolling is better than sitting around waiting for an unlikely dotcom recovery. But criticism of MBA programmes is on the rise, too—and not only on grounds of failing to deliver higher pay. Earlier this year the Aspen Institute published the results of a survey of 2,000 MBA students. It found that students' values changed during the course: by the end, they rated customer needs and product quality lower and shareholder value higher. It called for courses to give more concrete examples of how bosses balance the conflicting needs of business and society. (Moral tales may be in short supply these days.)

Another recent study, by the AACSB, which accredits American MBA courses, found that MBA graduates thought that the ability to communicate effectively with another person was the single most useful skill in their career—but that only 6% of business schools were even “moderately effective” in teaching that skill.

How to rectify these shortcomings? In another article in the new journal, Henry Mintzberg, a professor at McGill University in Quebec and long-time critic of MBAs, argues that management should be taught only to people who already have management experience; and that it must offer an opportunity for reflection as well as learning. He examined the careers of 19 Harvard MBAs who had made it to the top (40 of America's 100 largest companies are now run by MBAs) and found that ten subsequently ran into big difficulties: generally, their company went bust or they lost their job. And that most famous graduate from the Harvard class of 1975? “Stay tuned,” says Mr Mintzberg.

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German business schools

The cautious classmate

Jul 25th 2002
From The Economist print edition

Embracing American-style executive education, sort of

Get article background

GERMANY has never much warmed to American-style business education. Although plenty of Germans hold business degrees, these are mostly very different from the MBA; the long slog through theoretical economics and business mathematics bears little resemblance to the shorter, American-style degree, packed with case studies. The MBA was not even recognised in Germany until the late 1990s. Even now, Germany graduates only about 1,600 MBA students each year, compared with 13,000 in Britain.

Things are changing, slowly. Germany could gain a big new business school in October, when the European School of Management and Technology is expected to open in Berlin (though the first MBA students will not start until 2004). The school is backed by Germany's corporate heavyweights, such as DaimlerChrysler and Deutsche Bank. It hopes that its English-language programme will attract an international mix of students and professors, and thus allow it to compete with Europe's current leading business schools, such as Insead and the London Business School.

If successful, the new school should also help to improve the quality of German MBA programmes, which is a worry—especially as more and more state-funded professional schools spring up to teach business. FIBAA, a body that accredits German business schools, reports that there are about 70 unofficial MBA programmes in Germany, against only 35 that are officially recognised.

Germany's leeriness owes much to the structure of its educational system. Until recently, a single masters degree—typically lasting at least five years—was the university standard. Only now is that changing, as universities switch to a system that makes a short professional degree possible for the first time. But many university professors, especially the older ones, oppose the new system.

Another factor behind the MBA's slowness to spread is the “corporate university”. Many big German companies, such as Lufthansa and Allianz, run their own training centres for company management. This complements Germany's brand of capitalism, in which many workers stay at the same company for most of their working lives (making it worthwhile for the company to invest in their training). As labour becomes more mobile, says Michael Dowling, a professor at the University of Regensburg, other institutions are moving into executive education, but change is slow.

To outsiders, Germany may look like a rich market, poised to grow. Some American business schools have been pleased with the partnerships they have struck up with German schools—for example, the Kellogg School of Management, which has joined with WHU, a privately funded business school near Koblenz. But Germany has no stomach for a full-fledged American onslaught, as Duke University's Fuqua School of Business found out. With much fanfare, Fuqua opened a campus in Frankfurt three years ago to support a lavishly priced “cross-continent MBA” for executives willing to commute between Frankfurt and Durham, North Carolina. But the campus was quietly scaled back this spring, owing to a lack of takers. Germany, it seems, will not be rushed.

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Open-source software

Going hybrid

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Rumours of open-source software's demise are exaggerated

WHEN the hordes of volunteer programmers who make up the open-source movement met this week for their annual convention in San Diego, one constituency was conspicuously absent: entrepreneurs. Many start-ups that tried to make money from open-source software have already gone bust, and many of those that have survived are in a sorry state.

This is not all that is worrying open-source advocates. Microsoft is leading an increasingly nasty campaign against programs such as Linux, the free operating system, and has even been putting it about that such programs make it easier for terrorists to hack into computers. Worse, Linus Torvalds, the inventor of Linux, appears to have reached his limits as a manager. There is growing frustration among hackers that he is ignoring their contributions. Is open source doomed?

In part, the movement is a victim of its own hype. At the height of the “new economy” craze, open source was billed as radical new economics based on sharing. Programmers around the world contribute their time to write free programs so as to gain reputation among their peers. For this to work, the source code of a program—its basic ingredients—must be freely available, in contrast to the proprietary software of such firms as Microsoft.

Venture capitalists and Wall Street were wowed by the open approach. In 1999 public offerings by open-source firms broke all records: the shares of VA Linux Systems, for instance, gained almost 700% on their first day of trading. But these start-ups have since been flattened by the dotcom bust faster than other firms, in part because most of their customers were other start-ups fighting for survival.

To stay afloat, open-source start-ups such as VA are now having to become more proprietary. Even Red Hat, the leading distributor of Linux, is going hybrid. In January it introduced a high-end version of Linux that is not entirely open-source. Development of Linux is increasingly driven by large computer makers, such as HP and IBM, which are spending serious money to make Linux run on their hardware. IBM even discounts its mainframes if buyers use them to run Linux. Enterprise-software firms, such as Oracle and SAP, have rewritten their applications so they also work on Linux.

Development of Linux is increasingly driven by large computer makers, such as HP and IBM

Their aim is to undermine the market power not just of Microsoft, the firm behind Windows, but also of Sun Microsystems, which dominates the market for high-end server computers. If operating systems become a commodity, reason IBM and other Linux backers, then companies will spend more money buying their hardware, software and services. For similar reasons, RealNetworks, a multimedia-software vendor, said this week that it would publish the source code of a new set of programs called Helix. In doing so, it hopes to keep Microsoft from dominating the multimedia-software business.

Although this is all appalling to open-source purists, it may not spell the end for their beloved programs. On the contrary, it is likely to speed their adoption. Indeed, open source looks ideal for these difficult times. Free software is an attractive proposition when technology budgets are tight. Also, because more eyes look at the source code, it tends to be more secure and robust than proprietary software. Linux is thus winning unexpected converts, such as investment banks and government agencies. Since April, for

instance, Credit Suisse First Boston's global trading system has been running on Linux.

Small wonder that Microsoft should still be so rattled by open-source software. It is not so much the programs that the firm takes aim at, as the licence that comes with many of them: the general public licence (GPL). The GPL destroys intellectual property, argues Microsoft, because it dictates that all improvements, say to Linux, automatically become a public good.

Yet even Microsoft admits that open-source groups have many benefits, mainly because of better feedback between software developers and users. Thus, the firm has launched an initiative, called Shared Source, in which large customers can have access to the Windows source code, on condition that they do not modify or reuse it. Even Apple Computer, which guards its intellectual property jealously, has made an open-source program the core of its new operating system, called OS X.

Most surprising, however, is that firms outside the technology industry have taken to using open-source techniques. For instance, Dresdner Kleinwort Wasserstein, an investment bank, has released the source code for programs that link different computer systems within the firm. Barclays Global Investors, an investment-management firm, lets its programmers use the same development tools as open-source groups. Both firms are customers of CollabNet, one of the more promising open-source start-ups.

Having shown that there is, in many cases, a better way to develop code is undoubtedly the open-source movement's biggest achievement so far. And if Linux does one day become the standard for operating systems, as some enthusiasts predict, it will have taught the computer industry that it is more efficient to maintain its software infrastructure collectively. This would be bad news for Microsoft and Sun, but it would benefit customers—through greater competition, lower prices and, not least, better software.

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Defence alliances

Hands across the sea

Jul 25th 2002 | FARNBOROUGH
From The Economist print edition

Brothers in arms

Boeing and EADS trade insults, then sign a missiles pact

Get article background

FOR a while, it was business as usual at this week's Farnborough air show. Boeing badmouthed its European rival, Airbus, for building aircraft on spec and flooding the market. Hogwash, replied Airbus, which is catching up with the American market leader. Such spats are nothing new, though they are more piquant now that the pair are fighting over slim pickings in a market that has shrunk by half in the past year.

Fast forward to the afternoon of July 23rd and behold Rainer Hertrich and Philippe Camus, the co-chief executives of Airbus's parent, European Aeronautic Defence and Space (EADS), alongside Phil Condit, Boeing's chairman, posing for the cameras after signing a deal, all smiles. Welcome to the weird and wonderful world of defence aerospace, where politics often pushes together the deadliest of business rivals.

Just as most governments stop foreigners owning airlines on “strategic” grounds, so defence remains a nationalistic business. Cross-border deals tend to be ad hoc alliances and joint ventures rather than full mergers—much as airlines have to rely on alliances or forge code-sharing links to market each other's flights. The deal between Boeing and EADS is of this type. The two plan to co-operate on missile defence, Boeing being the lead contractor for the “ground-based interceptor” part of America's national missile-defence system.

This looks to be a feather in the Europeans' cap, since EADS has been struggling to break into the American defence market as Airbus has in civil aircraft. EADS and Boeing have joined forces on missiles before: for instance, Boeing helps to market the new EADS/BAE Systems Meteor. Most deals concern marketing or subcontracting. But this week's deal is about sharing development work. For once, it seems, America is treating the Europeans as equal partners.

The real motive, however, is the American government's desire to get the Europeans to warm to its controversial missile-defence system. America wants missile defence to be stretched to cover NATO's European members. One way of wearing down opposition among Europe's politicians is by demonstrating that there are jobs in it.

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Traditional Chinese medicine

Potions and profits

Jul 25th 2002 | HONG KONG
From The Economist print edition

Unorthodox treatments with plenty of potential, regulators permitting

AP

Money-spinning molecular cocktails

CHARLES HSU faces a dilemma. A venture capitalist with Walden International, an American firm, he knows that traditional Chinese medicine is a potential gold mine, and he has already scrutinised dozens of manufacturers in China. But so far he has had to turn them all down, because, as promising as their herbs and granules sounded, none could produce data or remedy definitions of the sort that regulators in America or Europe insist on.

That is frustrating, for the Hong Kong Trade Development Council reckons that the world market for Chinese medicine has doubled over the past eight years to about $23 billion. China, with its ageing population and rising wealth, accounts for part of this growth, but the biggest market is Europe. The Germans, in particular, have long welcomed “alternative” medicines and often stock them on pharmacy shelves alongside western drugs. The biggest potential market is the United States, where consumption of Chinese medicines has been growing by 25% a year since the late 1990s.

The problem is that regulators in rich countries are not keeping up with their consumers. Neither America's Food and Drug Administration (FDA) nor Europe's regulators consider traditional medicines to be proper drugs. Hence, Chinese medicine goes under categories such as “dietary supplements” or “health foods”. This caps the profitability of manufacturers, since the real money is in patented drugs.

Both the European Commission and the FDA have recently declared themselves open-minded about licensing traditional medicines. But the nature of such remedies throws up complications. Western drugs are made from single, identifiable molecules, whereas traditional Chinese or Ayurvedic (Indian) medicine is based on molecular cocktails.

To fans of the latter, this is exactly its appeal. Western medicine treats diseases in isolation, they argue, whereas Chinese medicine takes a holistic approach that has been refined over thousands of years. Western doctors and regulators counter that this does not remove the need for quality controls. At the very least, they want to be sure that each pill of a given brand is identical to every other.

Proving this is difficult. Often, traditional formulae are passed from one generation to the next, and much of the industry is located, literally, in the living rooms of practitioners. Traditionally, word of mouth has been the main form of industry regulation.

This has not stopped big companies in China, or conglomerates owned by overseas Chinese, from piling into the market over the past decade. Almost every Chinese university now has a research centre for traditional medicine that works with the industry. Realising that some quality control was needed, the Chinese government started monitoring production processes and awarding a “good manufacturing practices” label—the closest thing the industry has to a standard.

Wu Yibing of McKinsey's Beijing office thinks that western regulators and doctors will accept traditional medicines by a “slow evolution”. Hong Kong's government has identified Chinese medicine as a competitive niche and has asked Edmund Lee, who runs a research centre for traditional remedies in the city, to establish standards so that medicines can be better exploited commercially. Meanwhile, with or without venture capitalists, more and more Chinese companies involved in the business are striking it

rich. In June, Changchun Da Xing, a mainland company that gets 80% of its profit from a traditional treatment for cervical ailments, issued shares in Hong Kong and found them ten times oversubscribed.

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Face value

Deaths in the valley

Jul 25th 2002
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These are lucrative times for bankruptcy specialists such as Marty Pichinson

Get article background

IF THE grim reaper were to relocate to the west coast of the United States, he might look a bit like Marty Pichinson. The polo shirt and slacks are regulation black. But the face is tanned and relaxed, and the hips sport a mobile phone and a BlackBerry e-mail device, bringing modern productivity improvements to an ancient business. Sure enough, Mr Pichinson is a reaper, of sorts. His job is to close failing high-tech start-ups. The dotcom carnage made 2001 the busiest of his 21 years in the business. Then came a lull. By the start of this year, the worst seemed to be over, and Mr Pichinson began to retool the company he founded, called Sherwood Partners, for less grisly work. Those plans are now back on ice. “It's picking up again,” he says. “All hell has broken loose.”

Of the ten biggest bankruptcies in American history, five have happened this year. The latest to go down is also the biggest so far: WorldCom. Yet the sheer size of its collapse may be obscuring another important story unfolding among hundreds of smaller firms. The high-tech start-up bust was meant to be over, but there may be much worse to come.

After the partying of the late 1990s, restructuring specialists such as Mr Pichinson are the morning-after cure. Sherwood's niche is in the venture-capital industry, which, at the height of the boom, sunk tens of billions of dollars a year into what seemed to be promising young firms. Mr Pichinson enters the frame when those investments go so far awry that a bit of outside advice might help. Occasionally, he can fix things. But most of the time, he shuts companies down because, in four out of five cases, “they can go away, and nobody would notice the difference.”

Most restructuring specialists are accountants, whose sharp eyes and precise fingers pick the meat from the bones when companies fail. Mr Pichinson cut his teeth in the music business. He got his start booking bands in Chicago, then carved himself a niche managing R&B acts, which took him to Harlem, “a tough neighbourhood for a young Jewish boy.” He specialised in rebuilding acts, including The Miracles after Smokey Robinson left, Bill Withers and Lou Rawls.

With the entertainment and technology industries drawing closer, Mr Pichinson founded Sherwood Partners in 1992 to help struggling tech firms. The two worlds are not so different, he says. Both industries depend on talented, creative individuals. Both also need a little parental care for smoother running. “We had one high-tech client with two full-time chefs,” Mr Pichinson says, peering with indulgent amusement over the tops of his glasses. “We're the adult supervision in the sandbox.”

Since the dotcom bust, Sherwood has closed over 70 firms, including four companies on *Forbes* magazine's top ten list of recent tech start-up failures, Mr Pichinson says proudly. (These include Sigma Networks, a telecoms firm, and Kozmo.com, a business-to-consumer product-delivery firm.) Venture-capital clients, who like Sherwood's quiet, low-profile methods, include Softbank Capital Partners and APV Technology Partners.

In the 36 states that allow it, Mr Pichinson shuts firms using a non-judicial “assignment for the benefit of creditors” (ABC), a sort of gentle euthanasia that avoids the expense and conflict of the bankruptcy courts. Typically, ABCs take nine months to complete—about half as long as a normal bankruptcy—as everything from telephone systems to intellectual property is sold and the money handed over to

creditors. Mr Pichinson charges a basic fee of $17,000-20,000 a week, then takes a slice of whatever he collects for creditors.

Here comes another one

The dotcom firms that Sherwood was closing last year were of the sort celebrated by fuckedcompany.com, a website that has cast a sceptical eye on Internet firms with dubious business plans. Most of these have now been put out of their misery: dotcom shutdowns have slowed noticeably since the start of the year, according to webmergers.com, a research website—even as technology spending has continued to fall (see chart). The gathering second wave of tech start-up failures has begun to ripple through different industries, such as software, hardware, and telecoms services and equipment. “I thought things were stabilising six to nine months ago,” comments Bruce Claflin, the boss of 3Com, a telecoms-equipment firm. “But there's more to come.”

Typically, such firms have sucked up hundreds of millions of dollars apiece in funding, rather than the tens of millions that dotcom entrepreneurs blew. They are also less obviously worthless, says Mr Pichinson. The most common reason for failure, he says, will not be a daft business model or an absence of customers, but too much competition. Amid the relentless commoditisation of technology, he adds, “we have too much of everything.” One sign of the changing market is that Mr Pichinson wants to hire a merger specialist to clean up firms for sale, as industries consolidate.

Venture capitalists had hoped that it would be the companies in their portfolios that survived the coming shake-out. But souring financial markets, along with the endless corporate scandals that have followed the collapse of Enron, are fostering a new caution in the business of investing other people's money. “Nobody is going for the ‘last man standing' story any more,” says Mr Pichinson.

So Sherwood keeps growing. Two years ago Mr Pichinson had six employees. Now he has 25. By the start of next year, he says, he will have around 50, plus a new office in New York. For those investors who still cling to the hope of a quick recovery, Mr Pichinson's upbeat mood ought to be sobering. The tech shake-out, he predicts, has another three years to run.

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Turmoil in the stockmarkets

Fear, then greed

Jul 25th 2002 | FRANKFURT, LONDON AND NEW YORK
From The Economist print edition

AP

Wild mood swings in the world's markets

AT LAST, midweek, relief: a broad powerful rally that, close your eyes, felt like the old days. Dispelled, for a while, were those darker thoughts that sometimes found voice of late: might things get so bad that the Federal Reserve, exceptionally, would need to step in? There was talk of crisis meetings about to be called. What would happen if more mutual-fund investors left the casino? They cashed $14 billion of chips in June alone, according to Lipper, which tracks these things, and probably much more this month. Neither the mutual-fund industry, nor the stockmarket at large, has ever been tested by a panic-driven rush of redemptions.

Before the relief, stockmarkets in America had fallen day after day, with European markets anticipating the falls or reacting to them. Investors had nothing to clutch on to, and much to discomfit them. On July 22nd George Bush once again promoted views on share valuations, and once again investors preferred a president to a share huckster; they sold. The markets, too, had come to hope for decisive legislation from Congress to restore faith in companies and their accounts, yet over the weekend the expected agreement never materialised.

One reform measure, admittedly, had already been cast in stone: come mid-August, the chief executives and financial officers of 947 companies must sign off on, and be held criminally liable for, their accounts. That is welcome news in the long run; in the short term it means only worry, for all sorts of fresh surprises might crawl out of companies' balance sheets before the deadline. As if to confirm this general fear, Senate investigators alleged that two banking giants, Citigroup and J.P. Morgan Chase, had actively conspired with Enron to hide that company's debts from shareholders and regulators. In the markets, July 23rd was a day of maximum panic.

Fear turned to greed the next day—or perhaps it was just short-sellers covering their backsides. Certainly, apart from AOL Time Warner admitting to an SEC probe of its accounts, the news was more positive. Congress at last reached agreement on a tough new corporate-reform bill, which Mr Bush will sign (see article). And J.P. Morgan Chase expressed a strong intention to clear its name over Enron (see article). There was even relief at the indictment of Rigas family members for fraud at Adelphia Communications. At any rate, both the Dow Jones Industrial Average and the S&P 500 index staged their biggest one-day rallies since just after the crash of October 1987.

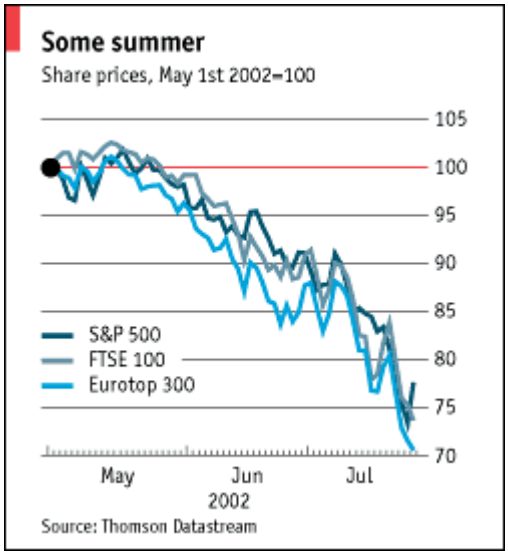
Even so, consider the damage to date. America's bear market since early 2000 has wiped out $5 trillion

of paper wealth. By July 23rd the S&P 500 index (much broader than the Dow), when measured by total returns, was 46.6% below its all-time high, according to Global Financial Data. That makes this the worst bear market since the depression of the 1930s—worse, even, than the vicious panic of 1973-74.

Europe has often fared worse still. In the four days of trading to July 24th, blue-chip indices in Frankfurt, London and Paris dropped by 11%, 10% and 12% respectively. Both France's CAC 40 and Germany's Xetra DAX have now fallen by well over half since peaking in 2000.

This week financial companies in Europe were hit hardest. For example, rumours of rising bad-debt provisions and an operating loss in the second quarter sent shares in HVB Group, Germany's second-biggest bank, down by nearly a fifth in two days, before the bad news was confirmed on July 25th. By and large, Europe's insurers have fared worse than its banks: the shares of Zurich Financial, for instance, fell by 14% on July 24th, before bouncing back. The drop in equity markets this year is awkward for insurers, because (unlike in America) equities account for a large slice of their assets. On top of this, says James Barty of Deutsche Bank, European insurers, big buyers of corporate bonds, have been caught by the collapse of the telecoms bubble, which was financed largely by bonds that have now turned to junk.

On July 22nd Aegon, a big Dutch insurance company, said that its earnings in 2002 would be 30-35% down, rather than being in line with last year's results, as it had previously hoped. The next day Fortis, a Dutch-Belgian insurer, also warned about profits: the market value of its equity portfolio had fallen below its purchase price. Suddenly European insurers had begun to seem like Japanese ones, with the possibility that they might become forced sellers of equities if markets tumbled further, reinforcing the fall.



The rally that sped around the world at midweek might now, perhaps, make room for brighter notions to be entertained. Take profits in America. Deception at WorldCom, Enron, Tyco and the rest, as well as huge write-offs at companies in telecoms and other sectors, have raised broad concerns about corporate profits. Yet if profits are measured properly, as Alan Greenspan, chairman of the Federal Reserve, suggested last week, then the concerns may be masking some positive signs.

Corporate profits, he noted, have risen sharply since the third quarter of last year, thanks in part to a big jump in productivity and to a decline in unit labour costs. So why is the stockmarket so sour about earnings? As Mr Greenspan pointed out, what you see depends on where you look. The profits that listed companies are reporting to their shareholders have indeed rebounded only feebly. The Fed, however, prefers to use the figures for profits included in the national income and product accounts (NIPA). These figures show a normal, healthy enough recovery.

The difference, Mr Greenspan suggests, lies with stock options. Almost all listed companies fail to record the stock options they issue to their employees as an expense in their income statement. That may have boosted profitability in the late 1990s, as more employees were willing to be paid in stock options in lieu of cash. Now that the market is slumping, the reverse has become true. The Fed calculates that the value of stock-option grants for S&P 500 companies fell by 15% between 2000 and 2001, and is likely to have fallen by even more this year. As stock options are replaced by stock and cash payments, which must be expensed, profits shrink. NIPA figures include the cost of options.

A more disconcerting picture of corporate health is given by the work done by a subsidiary of Moody's, a credit-rating agency. KMV uses quantitative modelling to look at equity volatility and company debt, to determine credit risk and the likelihood of default. The average American company, says Tim Kasta of KMV, now has a 4.4% chance of default, more than four times the average in the 1990s. Given recent stockmarket turbulence, the KMV model is bound to show some increase in risk. The concern is that even as the market value of their businesses falls, so companies have been adding debt.

According to the analysis, not a single American industry group has become sounder over a five-year period. Increased risk in the telecoms sector comes as no surprise, but equal risk in textiles does. Companies in both industries have, on average, a one-in-five chance of going bust in the coming year. Companies in computer software, cable television and computer hardware have a more than 10% chance of default. Even stodgy old utilities have a 9% chance. This possibility of widespread fragility among American companies may yet send markets down once again.

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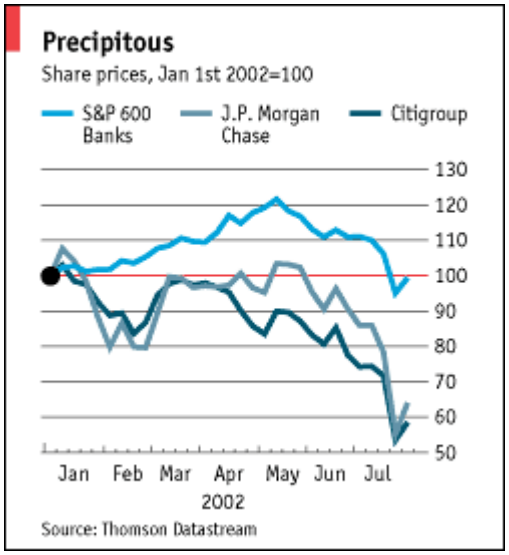
Citigroup and J.P. Morgan Chase

Banks on trial

Jul 25th 2002 | NEW YORK
From The Economist print edition

Did America's two largest banks go too far in their service to Enron?



UNTIL now Citigroup, and to a lesser extent J.P. Morgan Chase, have come through a slow economy in remarkably good shape—thanks in no small part to their transformation over the past decade into sophisticated and diverse investment banks. Enron has brought the dark side of this transformation to light.

Before a Senate committee this week, the two banks were slammed for structures that allegedly played a big role in Enron's efforts at accounting deceptions. In their defence, Citigroup and Morgan executives argued that the banks were, in fact, little more than Enron's victims; if further blame were needed, it should be directed at Andersen, Enron's auditor, which signed off on all transactions.

The stockmarket reacted by sending the two banks' shares down by a sixth on July 23rd, pounding other banks' shares for good measure. Whether a greater price is to be paid depends upon whether the actions are found to be merely embarrassing, rather than illegal. A case, says Diane Glossman at UBS Warburg, will not be easy to make.

The hearings focused on two sets of complex deals. The first involved so-called “pre-pay transactions”, in which banks put money up-front roughly equal to what specific energy trades might realise in future. Morgan structured 12 of these, providing $3.7 billion, while Citigroup structured 14, providing $4.8 billion. The key accounting question is whether this money should have counted as a loan, or as something closer to a payment for a future profit. If they were loans, the impact on Enron's balance sheet would have been profound. According to Robert Roach, the Senate's chief investigator, Enron's debt would have risen by 40%, while cashflow would have fallen by half. Representatives from credit agencies said that the changes would have had a harsh impact on Enron's rating and, as a result, its access to financing.

The second set was Citi's creation of a trust, called Yosemite, which issued notes to sophisticated investors, tied to Enron's creditworthiness. “Citi promised investors that the credit-linked notes would perform similarly to straight Enron bonds—and they have,” said Rick Caplan, a Citigroup executive.

“The Yosemite transactions transferred Enron risk exactly as they were intended to do,” agreed John Diaz, a managing director at Moody's. “The problem was that the actual Enron risk was different from that portrayed by Enron's incomplete and misleading financial disclosures.” Citigroup then used the money from the Yosemite offerings to fund the pre-paid transactions, creating what could appear to be a vicious circle.

All troubling for Citigroup, yet one contrarian in the market thinks things are not as bad for it as they might appear. On July 24th, the equity analysts at J.P. Morgan Chase added a big bank to its recommended list: Citigroup.

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Corporate reform

Congress acts

Jul 25th 2002
From The Economist print edition

A tough corporate-reform bill sails through

LAST May, when Paul Sarbanes, a Democratic senator from Maryland, first published his proposal for a new system of audit regulation and tougher penalties for corporate wrongdoing, few people believed that it would get anywhere. Then WorldCom admitted to a $3.9 billion fraud, public anger swelled over corporate misdeeds, and the Senate voted unanimously for the bill despite the efforts of accounting lobbyists. Now the Senate's blueprint for corporate reform has won against a weaker bill from Michael Oxley, Republican chairman of the House Committee on Financial Services. While the final bill that is expected to pass both houses contains some of the Republicans' provisions, these serve to make its provisions still tougher.

For accountants, the harshest aspect of the new legislation is its outright ban on nine kinds of non-audit service, including building financial-information systems, legal services and investment banking. In future, any non-audit work at all must be approved first by the company's audit committee. The bill stops short, however, of forcing audit firms to rotate their clients every few years, a requirement that is now being mooted in Britain.

The bill will set up a new board to oversee audits of public companies, with the power to investigate and fine auditors. To the dismay of accountants, who until now have more or less regulated themselves, the board will be independent in the way it is funded and staffed, and it will also have the power to set auditing standards.

Mr Oxley did make some changes to Mr Sarbanes's bill, for instance increasing the Securities and Exchange Commission's oversight of the new board. The House also toughened the Senate bill's punishments of executives. Wilful violation of a new obligation to certify the accuracy of their accounts will carry a sentence of 20 years, for instance, rather than ten years in the Senate bill.

Mr Sarbanes will soon receive a letter from Frits Bolkestein, commissioner for the European Union's single market, complaining about a provision in his bill that extends the jurisdiction of the new board to foreign accounting firms that audit companies listed in America. The broader issue for Europeans, however, is how far they should follow America's example on audit reform. As Congress was hammering out its bill this week, Britain's Department of Trade and Industry said that restrictions on non-audit services should be considered for Britain, too.

In America, Mr Sarbanes's draconian measures will be strongly felt. But they will take time to prove their worth at preventing future abuses and restoring confidence in capital markets—and, indeed, to lay bare any unintended consequences.

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Accountants

Revenge of the nerds

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From The Economist print edition

Applications to accounting courses in America are flooding in

“FORGET terrorism,” says Osama bin Laden on the cover of *Private Eye*, a British satirical magazine, “I'm going to become an accountant.” Accounting professors in America have been fretting that, thanks to a series of scandals, especially the fall of Andersen, even fewer young people will choose to become accountants. Instead, many more than usual have applied to study accounting in the months since Enron went bust.

At the University of Texas in Austin, for instance, the number of people who applied for this year's graduate accounting course has jumped by over half. At the University of Southern California's Leventhal School of Accounting, 185 people applied for its undergraduate accounting program starting this autumn, compared with 110 last year. At several of America's top accounting schools, says James Benjamin, head of the accounting department at Texas A&M University, many more undergraduates have applied than in most recent years.

One explanation is the uncertain state of the job market: the Certified Public Accountant qualification has always been seen as a safe bet in troubled times. Yet America's run of earnings restatements has also impressed on people that accounts and accountants matter. The dull, green-eyeshade image is being replaced by something altogether more creative, sexy even. After watching demand for their subject fall by a quarter over the past four years, accounting professors are delighted at the reversal.

To keep the interest of their new students, however, they must change the way they teach them, says Robert Sack, an academic. Courses, he says, should focus less on the rote application of rules and more on getting students to think for themselves. Would-be accountants should also ponder where to study, declares Richard Joseph, a lecturer at the University of Texas. Enron's main auditor from Andersen, David Duncan, who pleaded guilty to misdemeanours, graduated from the University of Texas's main rival, Texas A&M; but “the Enron whistleblower, Sherron Watkins, she's one of ours.”

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Hedge funds

Absolute disappointment

Jul 25th 2002
From The Economist print edition

Despite being in a bear market, hedge funds struggle to do well

Get article background

A YEAR ago hedge-fund managers were hailed as the new masters of the universe. One even made a cameo appearance in “Sex and the City”, a New York television series, as an over-confident suitor. (He got the girl, of course.) Hedge-fund managers once talked about a “special skill-set” that distinguished them from mere fund managers. They promised “absolute returns irrespective of market directions”. They put big chunks of their own money into their funds and, as well as annual management fees, took a reward of some 20%—and sometimes as much as 50%—of any gains made for clients.

Today, many hedge funds are performing poorly, and plenty are losing money. Managers now speak as if they are running a widow's fund: they stress the preservation of capital rather than outperformance. Most funds have parked more than a third of the assets they manage in cash instruments, and they have reduced their leverage (that is, the amount they have borrowed to speculate). Funds now admit that falling stockmarkets are proving unexpectedly painful.

An increasing number of hedge-fund managers are giving up. Earlier this month, Bayard Partners in London decided to shut down and hand back the money they were managing. In a letter to investors, the firm described today's markets as a toxic mixture of overvaluation, unrealistic expectations and sentiment-driven volatility. Those are conditions, you would think, in which hedge funds might be expected to thrive—but part of the problem, says Bayard, was a huge increase in European hedge funds in recent years, all seeking absolute returns to justify their fees. The amount of money under hedge-fund management in Europe has risen more than fourfold in the past three years.

Today more than 450 European funds manage $64 billion, about one-tenth of total hedge-fund investment, which is dominated by American outfits. So much money, pursuing relatively few investment strategies, reduces the potential returns for everyone. Fourteen funds have already thrown in the towel this year, says Iain Jenkins of EuroHedge.

Most hedge-fund managers on both sides of the Atlantic will soldier on for the time being. They argue that hedge funds' performance is still good—in relative terms. Last year the hedge-fund index compiled by CSFB-Tremont was up by 4.4%. That was a better performance than equities, but one that merely matched the yield on three-month American Treasury bills. “Last year hedge funds made only one-fifth of what investors have come to expect,” says Jacob Schmidt of Allenbridge, a fund-research group in London. In all, hedge funds this year have barely broken even.

Hedge funds vary so much that figures for the overall industry hardly tell the whole story. About half of all hedge funds are “long-short equity” funds. These buy undervalued equities, short-sell those they deem overvalued and often leverage their fund, too. Long-short equity funds are, on balance, down marginally so far this year. But those with an emphasis on buying shares have lost packets, while those that mainly sell shares short have done rather well. Some funds unafraid to take relatively larger risks have also outperformed. Lazard's European Opportunity fund is up by almost one-third this year, partly thanks to borrowing two or three times its assets.

“Relative-value” arbitrageurs are having a particularly tough time. These try to arbitrage away the differences in prices of, say, two convertible securities (usually, bonds that can be converted into equity). The market for convertible bonds is now dominated by hedge funds, which own more than half the convertibles outstanding. Outside Japan, new issues have dropped, reducing arbitrage opportunities. Further, extreme volatility in credit markets, where spreads have widened, makes credit risk harder to

hedge.

A recent study by Narayan Naik at the London Business School confirms a link between the current bear market in shares and the underperformance of various arbitrage strategies, broadly defined (that is, merger arbitrage, distressed investing, relative-value arbitrage and convertible arbitrage). The study shows zero or low correlation of these strategies with stockmarket returns when markets are going up, but a strong correlation when markets are going down.

Hedge funds' obsession with absolute returns stems from their aversion to being benchmarked—that is, judged against others. Yet more than a dozen hedge-fund indices now track the industry. Morgan Stanley, an investment bank, as well as Standard & Poor's, a rating agency, recently announced the launch of their own indices. Such indices are only a rough guide to the most heterogeneous of financial markets. Hedge-fund strategies vary too much to make meaningful comparisons.

Still, hedge funds' focus on absolute returns has also become synonymous with good returns at all times. Hedge-fund managers cannot deliver such miracles and some are no longer prepared to try. “The world,” says Nicola Meaden at Blackstone, an advisory firm, “is very different today than 40 days ago.”

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Japanese banks

Another time; another fix

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From The Economist print edition

Controversy over proposals to cure Japan's ailing banks

Get article background

IN THE late 1990s, the Japanese government tried to heal its ailing banks by pumping money into them, and the banks then spent most of their handouts bailing out dud borrowers. Big, weak banks also sought to fix themselves by merging with each other, but they failed to streamline their operations and become more efficient. The result today? The banks, with bad debts of ¥150 trillion ($1.3 trillion) and derisory capital, remain barely profitable.

Still, the government thinks that a combination of mergers and injections of public funds might work better the second time around. New proposals from the Financial Services Agency (FSA) unveiled earlier this month offer public funds (and other perks) to promote mergers between regional banks. Or so most people thought. It turns out, however, that the FSA did not exclude big banks from these measures: they too will be eligible for public funds if they decide to take regional institutions under their wing.

The regulator hopes to hammer out more details by the end of August. They are sorely needed. It has not yet been decided how much money will be available; what strings, if any, will be attached; or if the present bank management will be asked to step down. In any case, the measures are unlikely to promote efficiency. They serve merely temporarily to prolong the life of regional banks through mergers with equally weak partners.

The bail-out has also failed to satisfy the old guard within the ruling Liberal Democratic Party (LDP), which is pushing for more steps to help prop up sputtering regional banks. One group, led by Hideyuki Aizawa, a former head of the FSA and now chairman of the party's powerful committee on anti-deflation policies, is fighting the government over deposit-insurance reform, which is due to take place next April. That is the date by when the government has promised to lift its guarantee on ordinary deposits of over ¥10m.

Weak regional banks and credit unions, big lenders to hundreds of thousands of small businesses, especially in rural areas, are rapidly losing deposits as the deadline draws near. Some appear to be threatening to cut back lending, much to the consternation of politicians who fear that this could spark a wave of corporate bankruptcies in their constituencies.

Mr Aizawa wants the government to postpone lifting its guarantee on deposits indefinitely. He says his group is mulling alternatives, such as limiting the guarantee to regional banks, or setting a two- or three-year limit to the delay. Hakuo Yanagisawa, the financial-affairs minister, insists that banks are healthy enough for the guarantee to be lifted completely.

On July 22nd Junichiro Koizumi, the prime minister, openly challenged the dissenters in his party, by declaring that he did not expect them to delay reform. The signs are that this is the first round of a battle that will only intensify. Other proposals, such as a backdoor injection of public funds through the state loan-collection agency, are regaining popularity within the LDP. Although bank reform has stalled under Mr Koizumi, he has at least not pushed it back. Whether he can prevent others in his party from doing so is quite another matter.

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Trade policy

A ray of hope

Jul 25th 2002 | WASHINGTON, DC
From The Economist print edition

AP

Welcome to tariff country

Better news on at least three fronts

Get article background

GLOOM everywhere, yet the prospects for world trade talks look better now than they have for several months. The row between the European Union and the United States over steel tariffs has cooled. America's Congress is inching towards passing “fast-track” trade authority. And negotiators at the World Trade Organisation have even made progress on the preliminary stages of the new Doha trade round.

On July 19th the EU decided to postpone, until end-September, any decision to impose $380m-odd of retaliatory tariffs in response to America's decision last March to impose steel tariffs. The postponement came after the Americans added a further $60m-worth of European steel to the $230m-worth that had already been exempted from the tariffs. Around 13% of European steel exports to America are now excluded. America may well expand the exemption list over the summer. American steel companies will scream. With steel prices up, however, their results have improved.

Better relations between the EU and America will help the Doha negotiations. So far, attention in Geneva has been largely on the process rather than the substance. Yet the WTO's spokesman says that talks are “in relatively good shape”. The chances of substantive negotiations have risen further, after the Bush administration unveiled on July 25th ambitious proposals to liberalise agricultural trade. The administration (which, remember, upped hand-outs to their farmers this year) says it wants to abolish export subsidies and drastically reduce other trade-distorting assistance over five years. It also wants the Doha negotiators to set a date for abolishing all tariffs and distorting support.

Much depends on whether the administration can win fast-track negotiating authority from Congress. And here, too, there are signs of movement. The House of Representatives passed fast-track legislation by a single vote last December, while a rather different bill passed the Senate in May. Efforts to reconcile these bills have been set back by petty squabbles.

This week the logjam broke, as senators and congressmen sought a compromise. The White House belatedly started putting pressure on lawmakers, with President George Bush himself calling congressmen throughout the week. As *The Economist* went to press there was a chance that lawmakers might even agree a fast-track compromise, and vote on it, before the House of Representatives shuts up for the summer on July 26th.

Yet the odds are that the fast-track debate will drag on to September. It is said that Congress cannot pass a controversial trade bill as November's mid-term elections approach. That is not necessarily true, but with control of Congress up for grabs, it will need a big political commitment from Mr Bush. Plunging markets and the president's desire for some good economic news could be just the spur.

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Hungary's Postabank

For sale, again

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The new Socialist government thinks it can sell one of Hungary's biggest banks

NO BANK in Hungary's post-communist period has risen and fallen more spectacularly than Postabank. Built from scratch in 1988, it soon leapt ahead of most of its former state rivals to become the second-largest retail bank. Gabor Princz, its head, bankrolled politicians and amassed an array of media and property assets, including golf courses and a Czech beer factory. But doubts about the bank's financial health forced a state bail-out in 1997. A year later, another 152 billion forints ($700m) was spent recapitalising the bank; Mr Princz sensibly fled to Austria.

Now Postabank is in the spotlight once more. The new Socialist government has said that it wants to sell the bank, preferably to a foreign investor. This is not the first time that the state has tried to privatise Postabank. The previous conservative government wanted to sell it to OTP, a former state savings bank, but for more than the 25 billion forints that OTP offered. It refused to sell Postabank to foreigners, from whom it might have got a higher price. Instead, Postabank was placed under the control of the post office. Now there is reason to believe that the Socialists will close the deal. For one, they are not afraid of foreigners—when they were last in power, they sold two-thirds of the country's banking assets to foreign banks.

On the face of it, Postabank is an attractive prospect. With its big retail network in the country's post offices, Postabank could give a foreign bank a much-needed boost in the uphill battle against OTP, which still controls almost half of Hungary's retail business. Indeed, the suitors are already lining up, including Austria's Erste Bank and GE Capital's local subsidiary, Budapest Bank.

The challenge is working out what Postabank is worth. Attila Vago, an analyst at Concorde Securities in Budapest, says the bank could be worth as much as 40 billion forints. The books have been cleaned up (or so potential buyers hope), and the bank is mildly profitable.

Yet Postabank has been losing customers and has not invested in badly needed information technology. Peter Felcsuti, head of Raiffeisen Bank in Budapest, says that the bank is worth less now than the 25 billion forints that OTP once offered. For the moment—and no matter which bidder gets the bank—Postabank's competitors do not see a sale as putting the oomph back into this former high-flyer.

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Economics focus

How far is down?

Jul 25th 2002
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When valuing shares, orthodoxy is back in favour—with worrying conclusions

FROM the mid-1990s investors spurned orthodox ways of valuing shares. Such methods were deemed very old-economy. Lately, the idea that the rules have changed has been tested somewhat, and investors have been rediscovering old orthodoxies. But if they were hoping to find much reassurance, they will have been disappointed.

Alan Greenspan, chairman of the Federal Reserve, famously drew attention to the American stockmarket's possible "irrational exuberance" in December 1996, when the Dow Jones Industrial Average stood at around 6,400. Not exactly chastened, the market went from there to 11,723 at its peak in January 2000. With much, though not all, of that rise now reversed, old-fashioned methods of valuation suggest that shares are still expensive by historical standards. If you use such methods to ask where the floor for Wall Street might be, the answer is that it could be far lower than the levels—beaten down as these may seem—that the market has touched of late.

Mr Greenspan made his "irrational exuberance" comment after a meeting with a Yale economist, Robert Shiller, who apparently put the idea in his head. Mr Shiller went on to write a book, coincidentally entitled "Irrational Exuberance", which was published in 2000 just as the markets began their current slide. Mr Shiller's options on unlimited bragging have been hugely in the money ever since, though he has shown commendable restraint in exercising them.

Revisiting Mr Shiller two years on, he is still enlightening, and still rather scary*. He sets great store by the price/earnings (p/e) ratio: the share price divided by earnings per share. Mr Shiller follows the advice of Benjamin Graham, the godfather of classical equity valuation, in favouring, for the purposes of this calculation, a trailing ten-year moving average for earnings, since the underlying trend is what matters. Looking back as far as 1872, Mr Shiller finds that a "smoothed" p/e ratio calculated in this way for the S&P 500 index (a broader index than the Dow) has fluctuated with wide margins around a mean of 16. Before the 1990s, the highest it had ever climbed to was 28, just before the crash of 1929. At the peak in 2000 it was 45.

With the S&P 500 back in the 700s this week, the smoothed p/e is now in the low 20s. In other words, the index would have to fall to around 500 to pull the smoothed p/e back to its historical average. Yet there is no reason to regard even this as the floor. In the 1930s, the ratio fell to around ten. As recently as the early 1980s, the ratio has been less than ten. If this marks the floor, the markets could fall by another half, or more, from where they now stand.

Are things really this bad? Probably not. To see how some other factors fit in, look at the p/e ratio another way. As a matter of simple algebra, it is the inverse of the equity earnings yield (earnings per share divided by price). This in turn is a measure of the expected real return on equities. That historical-average p/e of 16 thus corresponds to a historical-average expected return of between 6% and 7% a year. Suppose, however, that investors in future no longer seek or require a return of 6% or more. If they would settle for a return of 5%, a p/e of 20 would be indicated. If they could put up with a 4% return (a mere percentage point above index-linked Treasury bonds), the warranted p/e would be 25—and the market might now be undervalued.

Stocks for the long run

Versions of this argument were advanced before 2000 to justify the markets' extraordinary rise. Equities had traditionally been seen as paying a risk premium over the return on safe assets. In fact, optimists

pointed out, so long as equities are held for the long term, they can be safer investments than supposedly riskless assets such as government bonds, whose value can be wiped out by inflation. The markets were soaring, it was therefore argued, partly because investors were coming to realise this. The risk premium was falling, and rightly so. As the risk premium fell, the required return on equities fell too—and the warranted p/e ratio was much higher than before.

This was not the only “new era” explanation for the great run-up in share prices. Optimists also emphasised the prospect for faster long-term growth in the economy. This would boost the growth of corporate earnings. With earnings on a higher growth path, current yields were understating the attractiveness of equities. Other things equal, the rate of return on equities would rise. Equity prices therefore had to go up in order to keep the expected return at the appropriate level relative to the return on other assets. (P/e ratios would soar for the time being, but then fall back as reported earnings caught up.)

Arguments about the risk premium, earnings prospects and other new factors (demographic shifts, the spreading share-owning culture, and others besides) were accepted far too uncritically in the late 1990s. They are now in danger of being entirely discarded, which would be almost as unwise. It was absurd (as is now obvious) to argue that equities were, in effect, a riskless asset—but it was true that equities have been a better bet over the past century than the normal risk premium seemed to imply. In the same way, hopes for higher earnings growth in the “new economy” were ridiculously inflated in the late 1990s—yet the evidence suggests that productivity growth in America really has improved, and some of this should be captured in faster-growing corporate earnings.

Over the next several decades, therefore, the smoothed p/e for the S&P 500 stands a good chance of beating the average of 16 it managed in the 20th century. Admittedly, this is not much help to investors right now. But to be any more precise would violate this column's fairly strict prohibition on calling the market.

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*As well as reading the book, see “Valuation Ratios and the Long-Run Stock Market Outlook: An Update”, by John Campbell and Robert Shiller.

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About sponsorship

Boeing's futuristic aircraft

Batwings and dragonflies

Jul 25th 2002 | FARNBOROUGH
From The Economist print edition

Boeing's Sonic Cruiser is struggling to take off. But even more fantastic models are on the company's drawing-board

Get article background

AT FIRST sight, it looks like all systems go. Boeing, one of the world's largest aerospace companies, has started wind-tunnel tests at the laboratories of QinetiQ, a privatised defence-research establishment in Britain, of a model of its proposed "Sonic Cruiser". This aircraft, if it is ever built, would be a 200-250-seater jet that would fly just below the speed of sound.

Boeing's bosses expect QinetiQ's tests to confirm promising numbers that emerged from the computers that helped to design the Sonic Cruiser. These suggest that the plane would be neither a gas-guzzler like Concorde, nor too noisy for modern airports. In other words, it might be a commercial runner. The basic design has been altered. It now bears little resemblance to the sketches released when Boeing launched the concept a year ago, in order to disguise its retreat from the "super-jumbo" market. Those sketches owed more to public relations than to aerodynamics. The new shape should actually stay airborne.

Being a runner, though, does not necessarily mean winning the race. The real barrier the Sonic Cruiser faces is not aerodynamics, but gloomy airlines. To begin with, there was some enthusiasm for a plane that could lop an hour off a transatlantic flight and three off some transpacific ones. But in their present slump, most airlines would probably prefer to see the technological tricks in the Sonic Cruiser (lightweight composite materials and so on) used to make planes that are more economical, rather than faster. Although the Cruiser would be no thirstier than an existing jumbo jet, that might still be too expensive in the future. Sir Richard Branson, boss of Virgin Atlantic and an early supporter, seems to have changed his mind. A few days ago, he poured cold water over the idea at the Farnborough Air Show, in Britain, saying that the Airbus A380 double-decker aircraft was the way of the future.

Cruising into oblivion?

The Sonic Cruiser may thus be a victim of bad timing. Indeed, Boeing now admits that it is talking to the airlines about 250-seater planes of a more conventional design to replace the firm's ageing 767. These aircraft would deploy the same weight-saving technology as the Cruiser, but in pursuit of economy, rather than speed. Boeing will have to choose which way to jump in the next few months, based on the reaction of a group of key airlines.

Holy Cow, Batman!

Even if the Cruiser crashes, Boeing is still looking at ways to escape from the tube-with-wings rut that has constrained commercial-aircraft design from its very beginning. Coincidentally, the firm's next tilt at this windmill is also being helped by British engineers. When funds ran out at NASA, America's aerospace agency, the company turned to Cranfield University to help it design models of its revolutionary "batwing" passenger plane. Blended wing/body (BWB) aircraft, as they are more technically known, were first dreamed up 50 years ago. The best known is the B2 stealth bomber. But none has ever gone into commercial service.

Boeing's first scale-model, developed with NASA, had a five-metre (17-foot) wingspan, and took to the air two years ago. It flew well enough to demonstrate that the design was aerodynamically sound. Now, Boeing and Cranfield are working on a 6.3-metre wingspan version to test the concept further.

Like the Sonic Cruiser, a commercial BWB will probably face scepticism from airlines and passengers. But enthusiasts in Boeing claim encouraging results from trials of mock-ups of the aircraft's interior. The first shock for passengers is to find themselves walking into a room similar to an amphitheatre or a hotel lobby, rather than the half-cylinder of a conventional jet. Another is the lack of windows, the presence of which gives a (falsely) reassuring sense of contact with the outside world in existing planes.

Boeing's answer to this psychological need is video screens linked to external cameras, so passengers can all see the Eiffel Tower whether it is to the port or the starboard of the plane. Another common objection from traditionalists is that seats at the plane's extremities would soar and dip too much as the pilot turns and banks. This is dismissed by George Muellner, the head of Boeing's Phantom Works, the firm's R&D organisation, and one of the champions of BWBs. The Boeing mock-up has simulated such motion and found that it is barely noticeable.

On the upside, there would be a greater feeling of space, the ability to have many more aisles, and a general freedom to move around—so avoiding flying hazards such as deep-vein thrombosis. But the earliest benefits from BWBs are likely to be enjoyed by military and air-freight users, who might be the first customers for the aircraft in about eight years' time.

According to Mr Muellner, BWBs are "volumetrically efficient". In English, this means that for a given load they need a smaller size. This, he says, translates into a gain of 18-30% in efficiency. Also, freight companies would be able to load standard containers on to a BWB in large numbers, something that is impossible with a conventional aircraft. Air-force chiefs are most interested in the planes as flight-refuelling tankers. Such tankers are increasingly important in modern warfare. A BWB tanker would not only offer better operating economics, but also the possibility, with its huge wing-span, of refuelling up to four fighters at a time. Today, fighters have to queue up behind a tanker like cars at an old village petrol pump.

Feeling the buzz

The third revolutionary aircraft in Boeing's stable is the X-50A, or Dragonfly to its friends. In this case Boeing has managed to find an American partner. The Dragonfly is being created in collaboration with the Pentagon's Defence Advanced Research Projects Agency. It is one of a number of Unmanned Air Vehicles (UAVs) that Boeing is developing in partial compensation for its loss of the huge Joint Strike Fighter contract to its big rival, Lockheed Martin. Like a real dragonfly, the X-50A can stay airborne without moving. But it can also zoom like a jet plane.

Dragonfly is a cross between a helicopter and a fixed-wing aircraft. It has a conventional turbofan jet engine. For fixed-wing flying the rotor becomes a wing, and the engine's thrust-generating exhaust is blown through a jet at the rear. When it is operating as a helicopter, the exhaust is diverted to the rotor-tips, a concept first developed (but dropped) in Britain about 40 years ago. All this eliminates the need for heavy mechanical transmission gears, so the X-50A is both lighter and cheaper to operate than a conventional helicopter.

Dragonfly's versatility could make a manned version attractive to special forces, which need to move fast, and also like to get into and out of dangerous places as rapidly as possible. The first two demonstrators are due to fly in September. Boeing envisages the UAV being followed by a bigger piloted

aircraft. Even if the Sonic Cruiser does not make it to market, that does not mean that no exciting new aircraft are coming along.

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Alzheimer's disease

Inside story

Jul 25th 2002
From The Economist print edition

It is now possible to see the spread in a sufferer's brain of Alzheimer's disease

ALZHEIMER'S disease is by far the commonest form of dementia. It affects 5-10% of people over the age of 65, and 30-35% of those over 85. It is also far from being understood. Until recently, it could be diagnosed with certainty only after a patient had died. This was done from the characteristic plaques of a protein called beta amyloid that build up in the brains of sufferers. This protein seems to be associated with the death of nerve cells, which brings about the memory loss that is the chief symptom of the disease.

At the International Conference on Alzheimer's Disease held recently in Stockholm, a number of researchers described how this ignorance might be overcome using brain-scanning techniques. Such techniques might, eventually, help with both diagnosis and prognosis—including recognising who is at risk before their symptoms appear. More immediately, they could speed up the testing of anti-Alzheimer's drugs, by showing researchers what effects, if any, such drugs have on the diseased brain.

Peering in

To detect amyloid plaques in dead tissue requires the use of special stains. About ten years ago Chester Mathis and William Klunk, of the University of Pittsburgh, wondered if a similar staining technique could be applied to the brains of the living.

Their idea was to find a stain that could include a radioactive atom that produced a positron when it decayed. That would mean it could be used in a scanning technique called positron-emission tomography (PET). Such a stain would have to be safe, of course. It would also have to be able to cross the blood-brain barrier, the system of defences deployed to keep unpleasant chemicals in the bloodstream from gumming up delicate neural tissue. And it would have to stick to beta amyloid in preference to anything else.

The molecule that Dr Mathis and Dr Klunk settled on is known as 6-OH-BTA-1. The version used incorporates carbon-11, one of four types of positron-emitter used routinely in PET. After extensive tests on animals, this technique has recently been applied to people by Bengt Langstrom of the University of Uppsala, in Sweden.

Dr Langstrom's results, which he reported to the conference, suggest that 6-OH-BTA-1 does indeed work well as a “living” stain. Although confirmation must, regrettably, await the deaths of the subjects, the pattern that the stain outlines in the brains of those who show symptoms looks like the pattern that plaques generally form.

Eric Reiman, of the Arizona Alzheimer's Research Centre, in Phoenix, and his colleagues, are pushing PET further. They have used a different version of the technique to show that the brains of people as young as 20—decades before any outward symptoms appear—may show signs of the disease to come.

Active brains consume a lot of energy, but as nerve cells die during the progression of the disease, so demand for energy drops in the affected area. The body's chief source of energy is glucose, and it is possible to get a good idea of local energy consumption by injecting somebody with a form of glucose that contains fluorine-18, another positron emitter. Like normal glucose, this concentrates in regions of high energy demand and is absent in regions of low demand. Put a person with Alzheimer's disease in a PET scanner and you can see the afflicted regions of the brain by the way they do not light up.

Dr Reiman and his team have been trying to find out how early in life the disease starts to manifest itself. One of the biggest risk factors is the presence in an individual of a gene called APOE-E4, so they have been comparing people who have a copy of this gene in their cells, with those who do not. They have in the past shown that APOE-E4 carriers aged 50-65 tend to burn less glucose in the same four parts of the brain as those who already show symptoms of the disease. That is not surprising, since symptoms tend to appear in a person's late 60s and 70s. At the Stockholm conference, though, the team announced that the same thing is true for those in their 20s and early 30s. It looks, in other words, as though an individual's cards may be marked early in life.

Determining exactly which individuals are affected is beyond the scope of Dr Reiman's technique, since it works by averaging the results from several people carrying APOE-E4, and comparing them with a similar average from non-carriers. However, Nick Fox and his colleagues at the Institute of Neurology, in London, are hoping to change that.

Dr Fox uses magnetic-resonance imaging (MRI) rather than PET. This works by stimulating the nuclei of particular atoms, notably hydrogen, to give out radio signals. Different tissues have different amounts of hydrogen in them, and so look different to the scanner. Dr Fox's contribution to the field is a trick he calls voxel-compression mapping. This allows a series of images taken of the same individual at different times to be compared.

MRI images are three-dimensional and, just as a two-dimensional image such as a television picture is composed of “pixels”, so a 3-D one is composed of “voxels”. An image of a human brain contains about 1m of them. Voxel-compression mapping works by using a computer to identify an optimal fit between two images. Even in the brain of somebody who has Alzheimer's, most of the voxels will be unchanged from one picture to the next. That provides a frame of reference for examining those that have changed.

When the best possible match has been made, the program identifies those voxels which do not fit and works out how much each has been squeezed or stretched from one image to the next. These changes mark the progress of the disease, which Dr Fox has shown starts in a part of the brain called the hippocampus that is involved in the creation of permanent memory.

Dr Fox's work, like Dr Reiman's, has shown that people's brains are affected before they display any symptoms. It has also shown that in a given individual, the rate at which the disease progresses is fairly constant. That gives drug companies something to bite on, since they will be able to see month by month whether their test compounds are actually working.

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Alcohol and health

The key to gracious living

Jul 25th 2002
From The Economist print edition

Drinkers, it seems, often lead healthier lifestyles than the teetotal

ABOUT ten years ago, the French found something they had a legitimate right to feel smug about. To their astonishment, epidemiologists began to notice that French people, who wash down meals laced with cream, cheese and animal fat with flagons of wine, not only live longer, but also suffer less heart disease, than people from other countries. The most popular explanation for the so-called “French paradox” has been that chemicals present in wine can counteract the ill effects of fat and cholesterol on the heart and arteries.

Beware, however, whenever a hypothesis—in this case, that wine makes you healthier—accords too closely with what you want to believe. Further investigation of the effects of wine on health muddied the picture, especially when wine consumption was studied in other countries. As a rule, richer folk tend to prefer wine over spirits or beer. In the West, higher socio-economic status is correlated with less heart disease and longer life-spans. So some doctors argued that it is their money and not their tipple that is responsible for the longer lives of wine-drinkers.

Now John Barefoot of Duke University in North Carolina, Morten Gronbaek of the Institute of Preventive Medicine in Copenhagen, and their colleagues have poked a hole in this explanation too. In the August issue of the *American Journal of Clinical Nutrition*, the researchers report some surprising correlations between what people drink and how they live, even when the people concerned have roughly the same socio-economic status.

To separate the effects of money from the effects of diet and choice of drink, Dr Barefoot, Dr Gronbaek and their team analysed data from a group of subjects who possessed similar financial means and social standing. Their subjects were participants in a long-term heart study of students from the University of North Carolina who had entered that institution in the 1960s. These participants and their spouses, now numbering about 4,500 people, are overwhelmingly white, highly educated, middle-aged and affluent. Luckily for the investigators, they also show some variety in their taste for alcohol and in their diets and lifestyles.

After receiving the subjects' responses to their questionnaires, Dr Barefoot and his colleagues divided the group into five sets, depending on whether they were drinkers of beer, wine, spirits, none in particular, or no alcohol at all. To be classified as having a preference for a particular form of alcohol, a subject had to report that he drank more than half of his alcohol in this form. In addition, the subjects were asked to report their weight, their food intake and their smoking and exercise habits. Finally, the researchers gathered statistics on the education and occupational prestige of their subjects.

When these data were analysed, Dr Barefoot and his colleagues found that wine-drinkers ate less saturated fat and cholesterol, smoked less, and were more active than the rest. Those who drank no alcohol had the worst habits: they ate fewer fruits and vegetables and more red meat, and also smoked more. When the researchers controlled for connections between socio-economic status and beverage preference, they found that wine-drinkers with the same financial resources and social standing as beer-drinkers or teetotallers simply lead more sensible and healthier lives.

Despite allowing themselves the indulgence of wine-drinking, members of this group practised reasonable self-discipline in matters of diet, exercise and smoking. According to the researchers, the lifestyle led by wine-drinkers explains much of their better health. Whether encouraging the abstemious to drink wine would cause them to lead healthier lives is moot.

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Venetian glass

Red hot

Jul 25th 2002 | MURANO
From The Economist print edition

A newly opened school near Venice hopes to keep alive the craftsmanship of its famous glassblowers—and perhaps win back a reputation for making art glass

WHEN glassmakers fled Murano to join the Florentine court of the Medicis, even the boatmen who rowed them across the Venetian lagoon were imprisoned. Exile and possible death faced anyone who revealed the vitreous secrets of Murano, and the master glassblowers of the Renaissance—though handsomely paid and often ennobled—were forbidden to leave *la Serenissima*. Their techniques for perfecting the crystal lightness, the filigree decoration and the jewel-like enamel hues of Murano glass remained a Venetian monopoly for centuries.

No longer. Now Murano is inviting the world to learn its secrets, with the opening of its first professional glassblowing school. The founder is Rosa Barovier Mentasti, a scholar of glass and a descendant of an old glassblowing dynasty listed in the "Guinness Book of Records" as the world's oldest family of glassmakers. Her mission is to revive the art form that made Murano famous and to add academic rigour and respect to a profession that is still regarded as being too constricted by an ancient master-and-servant culture.

Ms Barovier is concerned that Murano might be losing a younger generation of glassblowers. Their parents equate blowing glass with menial labour and want to send them to university rather than enrol them as apprentices. She hopes the new Abate Zanetti school (named after the man who founded a drawing school for Murano workers in the 19th century) will help pass on Murano's traditions, while also providing the benefits of a modern education so that the school attracts young glassblowers from all over the world.

Swapping skills

Ms Barovier sees the school as involving every generation of the Murano community in promoting the tiny island's glassmaking prowess. She employs retired master glassblowers so that they can pass on the ancient skills of a craft that has changed little for seven centuries. But she also invites contemporary glass masters from around the world to run workshops. One of the most famous, Murano-born Lino Tagliapietra who moved to America in the early 1970s, advised on the layout of the furnaces and will return to teach. But the school also offers courses in English, design, computers and art history. And it promotes international exchanges, sending young Muranese glassblowers overseas and inviting glassmakers from Scandinavia and the United States to observe Italian craftsmanship at first hand.

Not everyone, however, thinks the glass school is a good idea. Ms Barovier concedes that some of the older local glass blowers opposed the idea at first. "'The best school is the furnace', they said. But it is no longer acceptable for young boys to enter the furnace at the age of 12 and not receive any other formal education." She also faced years of wrangling with Italian bureaucrats in setting up the school, and when it finally opened earlier this year, not only was it still short of essential funding, it hadn't yet been given the permits it needed to operate the furnaces. In true Venetian style, though, it opened anyway, with a summer school that took in foreigners whose fees helped subsidise the local students.

Some sceptics complain that the school, however ambitious, is still a case of too little too late. Caterina

Tognon owns a studio glass gallery bearing her name, which has showrooms in Bergamo and Venice. The gallery stocks the work of mainly American and northern European glass artists, whom she sees as possessing a wider vision than that of the Muranese glassblowers. Ms Tognon despairs of the conservatism of the Muranese, who, despite their world-class skills, remain so hidebound by their traditional systems of apprenticeship that artistic innovation, she says, is rare.

But Ms Barovier remains unflappable. She cites young, talented Venetian glass artists who have been nurtured in the Murano tradition, such as two siblings, Laura and Alessandro di Santillana, who are descendants of the renowned Venini glass family. Laura turns flat glass vases into Rothko-like colour studies, while Alessandro (who will also teach at the school) makes striking modern sculptures that play with the mirror, light and water effects of Venice. Both have had the benefit of a broader education than the typical Murano glassblower, and both have opened their own design studios which have made their reputations in Venice and internationally. Ms Barovier believes education and travel prompt innovation, and she wants the school to offer such opportunities to Muranese glassblowers.

Her confidence stems in part from her family's distinguished history of innovation in glass. Angelo Barovier, the most famous glassblower of the Renaissance, invented the pure, clear *cristallo* glass that became a Venetian trademark and appears in paintings by Bellini, Titian and Veronese. Another more recent ancestor, Ercole, revived Venetian glassblowing in the early 20th century, using the malleability of glass to transform it into myriad new forms, from mosaic patterns to sculptures and delicate vessels as ephemeral as air. His pieces rarely come up for auction, but fetch world-class prices when they do.

Ancient lineages

The Baroviers, who once supplied glass to popes and kings and are now decorating Elton John's Venetian palazzo, have enshrined much of their family history in the Museo Barovier & Toso. Located above the company headquarters in a 17th-century Murano palazzo, it displays the private collections of Ercole and his son, who, unique among Venetian glassblowers, saved their pieces and their drawings in an archive of their work. Older Barovier creations are kept at the nearby Murano glass museum, which records the history of Venetian glassblowing from the 10th century, when traders brought back Islamic glass enamelling techniques from the Levant and built the first furnaces.

Given her lineage, Ms Barovier might well have adopted the airs of a grand Venetian. Not a bit. Rough and ready, her only jewellery a bracelet made by a student, she wants most of all to spread knowledge well beyond Murano. One of her protégés is a former glassmaker whom she encouraged to pursue his love of cooking. He now runs the best restaurant in Murano and is so successful that he sponsors a course at the new glassblowing school. In a country which treats food, as well as glass, as an art form, passion is the inspiration.

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About sponsorship

Glass on show

Blowing baubles

Jul 25th 2002
From The Economist print edition

A major exhibition and a new museum highlight the popularity of glass as art

FOR centuries, glassblowers in Venice were treated as mere artisans. Now, inspired by the appeal and innovation of glasswork in Scandinavia, Japan and the United States, they are treated as artists.

In addition to opening the new glassmaking school at Murano, Rosa Barovier is co-curating a show called “Glassway”, which looks at the history of glass from antiquity to today and brings together 400 works from everywhere in the world where glass has been made.

The exhibition, at Aosta's **Museo Archeologico Regionale** until October 27th, takes a thematic look at how glassmaking has been an inspiration for technical and artistic innovation since it was developed thousands of years ago in Mesopotamia. Alongside rare historic pieces, and contemporary works by such masters as Timo Sarpaneva and Tapio Wirkkala, who are both Finnish, there are works in glass by Louise Bourgeois, Joseph Beuys and Marcel Duchamp, as well as that of younger artists including Jaume Plensa and Wim Delvoye. For Ms Barovier, it is hard to see where craft ends and art begins: “When I look at a Murano vase and a painting, it is hard for me to say that one is art and one is not.”

Dale Chihuly, probably the best known American glassmaker, would certainly agree. After visiting Murano in 1968, Mr Chihuly returned to Seattle, luring a number of Venetian glassblowers, including Lino Tagliapietra, to join him. For Mr Chihuly, glassblowing was part of a counter-cultural trend. He built a hippy commune at Pilchuck not far from Seattle, where people camped and tripped out on making glass. Most importantly, he inspired people to experiment with glassmaking as art. From his efforts was born the term studio glass—meaning glass art rather than utilitarian objects—a child of the 1960s that became a huge commercial success by the 1980s.

Cynics might regard the studio glass that is now being produced in Seattle as the decaf latte of glassblowing—a clean-cut, healthy and lucrative adaptation of Italian traditions for American taste. But beyond the fact that both the glass movement and Starbucks hail from Seattle, the comparison is extreme. Earlier this month, the glass master's home town of Tacoma, Washington, a 30-minute drive from the city, honoured Mr Chihuly by opening a museum dedicated to contemporary glass art.

Called, rather long-windedly, the **Museum of Glass and International Centre for Contemporary Art**, it doesn't yet compete with the **Corning Museum of Glass** in New York state. Despite that, its enormous conical construction contains the world's only amphitheatre “hotshop”, where up to 150 people at a time can watch glass masters at work. Meanwhile the ubiquitous Mr Chihuly has built a bridge of glass connecting the waterside site with Tacoma's downtown area. Murano's Renaissance glass masters, who were so protective of their trade secrets, would be astounded.

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Indian cricket

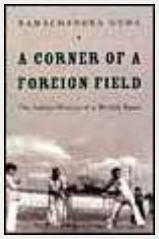
Great balls of fire

Jul 25th 2002
From The Economist print edition

AT THE Test match between England and India that began on July 25th, 28,000 spectators crowded into Lord's cricket ground in London for a five-day game, the first of four. About 1m more will be watching on televison. These are footling numbers. In India, the television audience will be measured in hundreds of millions.

Cricket is followed as widely and as passionately in India as football is in Brazil. That huge television audience has earned hundreds of millions of dollars for the international game; unheard of riches for a sport that was a latecomer to commercialisation. Indian cricket is a phenomenon, and the rest of the world is trying to come to terms with it—often with little success.

A Corner of a Foreign Field: The Indian History of a British Sport
By Ramachandra Guha



Picador; 496 pages; £20

Buy it at
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Writing 20 years ago, Scyld Berry, a shrewd and knowledgeable cricket commentator, made the following simple prediction: “India is destined to become the capital of cricket.” So it has, in all but name. Behind its high brick wall in expensive St John's Wood, Lord's cricket ground still houses the International Cricket Council (ICC), the game's governing body. But the influence has shifted elsewhere. Supporters of the game in the old white Commonwealth nations believe they are facing a sub-continental takeover—as well they might—and many are hostile to the idea.

Cricket fans who fear or oppose India's claim to hegemony ought to read Ramachandra Guha's fine history. They might be no more sympathetic, but they would understand it better. Mr Guha is a historian by instinct and by profession, and he has written a largely untold story: a fluent and entertaining social history of Indian cricket. (Mihir Bose's 12-year-old “History of Indian Cricket”, now republished, is more an account of great matches.) Cricket instilled confidence in the independence movement: if Englishmen treated them as equals on the cricket field, why not off it? When C.K. Nayudu, a fine, wristy Indian batsman, scored 153 for the Hindus against the Marylebone Cricket Club (MCC) in 1926 it had a wider significance: “Every sixer hit by C.K. against the visitors...was as good as a nail in the coffin of the British Empire.” And it helped absorb Dalits, then known as Untouchables, into mainstream Hinduism. The spine of the book is the story of two brothers, Baloo and Vithal Palwankar, both Untouchables, whose cricket skills persuaded their fellow Hindus to treat them like human beings.

AP

Ganguly goes for it

Until the 1930s the cricket season's climax was a Quadrangular Tournament in Bombay—the four teams composed of Europeans, Parsis, Hindus and Muslims. The Quadrangular did not survive independence. Some Congress party politicians did not expect cricket to last either (“it can only survive in the atmosphere of English culture, English language and English rule”). How wrong they were. “What made cricket in India after 1947 was the energy, the excitement, the noise and the nationalism,” says Mr Guha. “Cricket indulges Indian taste for chatter and disputation, gossip and debate.” He might have added gambling and match-fixing too, because the canker of modern cricket rooted and grew in India, though he has little to say about it. Perhaps it is too painful.

Cricket has become a reflection, a focus and an instrument of Indian nationalism. The Bharatiya Janata Party (BJP) is quick to ally itself with Sourav Ganguly's team, especially when it wins. But religion and nationalism have left a baleful legacy. A former Indian external-affairs minister said that Tests between India and Pakistan are “less cricket and more gladiatorial contests”. The crowd had to be locked out of Eden Gardens in Calcutta in 1999 to enable a Test to be finished and the two teams have not played since. They are unlikely to do so until the BJP loses power. The inability of neighbours to play a game against each other frustrates the television magnates and the fans. (Why not play at Edgbaston in Birmingham instead?) It may even be one reason why India and its allies do not launch a full takeover bid for the ICC. When it comes it will be driven by energy, excitement, nationalism and noise. The English will not like it one bit.

A Corner of a Foreign Field: The Indian History of a British Sport.
By Ramachandra Guha.
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About sponsorship

New theatre

From the rubble

Jul 25th 2002
From The Economist print edition

Two plays about Israel and Palestine

A FRIEZE of suffering and anger does not make for dramatic theatre, not even political theatre. But “Alive from Palestine: Stories under Occupation” by the Al-Kasaba company from Ramallah has its own undeniable power. The company's stage was badly damaged last April in the Israeli occupation of the town and curfews have played havoc with rehearsals. So it was by a small miracle of will and improvisation this summer that Al-Kasaba reached New Haven, Connecticut, and more recently London's Young Vic theatre for a ten-day run of its 70-minute protest play.

Out of rubble represented by piles of crumpled newspaper clamber five men and a woman, walking as in a dream. They act out or tell us about normal Palestinian life. (They speak in Arabic, with English surtitles.) Much of it is, alas, what you might expect: a man goes through the school bag of a dead child; another, caught in a helicopter's searchlight, pleads with the pilot.

The strongest moments are when humour and fantasy are given rein: a man turns into a suitcase; a young suitor promises happiness in a refugee camp; a couple, trying to reach the university, find routes blocked: by tanks, by snipers, by mines...by a night-grown Israeli settlement, “Where did that come from?”

The feeling of isolation and victimhood is overwhelming. The one true cry of protest is from the woman, who finally shouts, “It's not normal.” The end is moving, but bleak. To have seen “Alive from Palestine” the day that news came of an anti-Hamas Israeli missile attack in Gaza killing many civilians, including children, only added to the feeling of hopelessness.

“I hate Hamas myself,” says George Ibrahim, a Palestinian producer and cultural leading-light who runs the Al-Kasaba company. Hamas, to him, are criminals, but he adds, “I also know why.” Though grimly fitting, his words come in fact from “Via Dolorosa”, a one-man play by David Hare, who visited Israel and Palestine four years ago, talking to people on all sides, including Mr Ibrahim, trying to understand.

The play, which consists simply of his reports and thoughts about what he heard, was widely praised when it showed in London in 1998 and then in New York. In a welcome revival, with minor changes (a mention, for example, of Ariel Sharon), it opened at London's Duchess theatre on July 18th for a six-week run.

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The history of maps

Squaring the circle

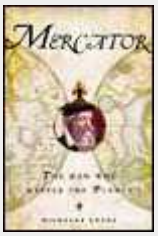
Jul 25th 2002
From The Economist print edition

THE images of Mars that the *Mariner 9* spacecraft sent back to earth in the early 1970s were reproduced as maps according to rules that were first drawn up in 1569 by a frugal Dutchman. Those mapping rules have endured because, though wrong in significant ways, they have proved supremely useful.

Gerard Kremer, who used the Latin name Mercator, was born in 1512, in the low countries. Taxes were punitive, especially when new armies and horses were needed to defend the mostly Protestant region from Catholic invaders. Poor and unsettled, the area was nonetheless at the centre of a vital trade route that ran the length of the Scheldt river, connecting Antwerp, and England to the west, with the inland wharves of Ghent, Brussels and Brabant.

Mercator started out as a religious philosopher, but was assailed by doubts when he found that he could not reconcile the biblical account of the origin of the universe with that of Aristotle. A meeting with Gemma Frisius led to a resolution of his intellectual crisis. Frisius was not only one of the leading astronomers of his time, he was also a superb mapmaker. Mercator moved to Louvain to be with him, and plunged himself into geography and engraving. He soon mastered Frisius's technique of triangulation for surveying. In 1535 he helped Frisius make the first terrestrial globe, followed quickly by a celestial counterpart. A collection of maps published in 1595, the year after he died, made use of the word “atlas” for the first time.

Mercator: The Man Who Mapped the Planet
By Nicholas Crane



Henry Holt; 320 pages; $26.
Weidenfeld & Nicolson; £20

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Mapmaking in the 16th century was a slow and difficult business; Mercator himself described it as *laboriosissimum*. Mercator built his reputation as the foremost geographer of the century without going to sea. His famous printed cartographic works were based on the careful reconciliation of surveys made by other travellers. Cartography was subject to other pressures: mapmakers would mark in Protestant regions as Catholic ones, or vice versa, as fortunes shifted or to please their clients; with navigators in mind, they might insert a hitherto unknown sea passage into an uncharted landmass.

Mercator was not above this sort of thing. His 1564 map of Britain, commissioned by the Duc de Guise, showed Scotland, France's ally, as big as England, and lavishly populated with castles, lakes, forests and hills. A silver commemorative medal struck for an English client had not just “Virginea” under the sway of England but the western part of the United States described as “New Albion”.

Publishing a map, in sum, was as good as broadcasting religious opinions or staking political claims. It could mean prison or death if the mapmaker found himself in the wrong place, or the winds changed. Mercator's inclination towards Protestantism and his frequent absences from Louvain to gather information for his maps aroused the suspicion of the Catholic authorities, who had him arrested in 1544 and imprisoned for seven months on charges of heresy.

Only on his release did Mercator return to the momentous question that had vexed him since the beginning: how was a cartographer to unpeel the planet's skin and set it down flat with an acceptable minimum of distortion? The problem of representing the world on a plane surface had puzzled mapmakers ever since they had accepted that the earth was round.

Despite his lack of experience at sea, Mercator knew what mariners wanted. The easiest course for a sailor to steer is one whose heading is constant: to keep your bearing, you simply need a compass. On a sphere, a steady course of this kind will trace out a mathematically tricky open spiral. Mercator's breakthrough was to provide sailors with a map on which they could plot fixed courses as straight lines.

His projection was a navigator's godsend, but as a representation of how things are, it came with well-known costs. On a sphere, north-south circles meet at the poles. On Mercator's map, they are parallel. So east-west distances widen artificially, the higher or lower you go. To compensate, lines of map latitude must also be drawn farther and farther apart. As a result, Canada, Greenland and Siberia are much too big, though most of us are so used to this that we hardly notice.

Mercator's story is fascinating, and although Nicholas Crane's writing is uninspired, his book is a good introduction to the father of modern mapmaking.

Mercator: The Man Who Mapped the Planet.
By Nicholas Crane.
Henry Holt; 320 pages; $26.
Weidenfeld & Nicolson; £20

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New fiction

Eastern melancholy

Jul 25th 2002
From The Economist print edition

ADMIRERS of John Lanchester's elegant culinary thriller “The Debt to Pleasure” have long hoped for an equally dexterous successor. “Mr Phillips” was a strangely pedestrian disappointment. But “Fragrant Harbour” succeeds, at least in part.

It starts unpromisingly, as the clunking title warns us. The setting is a formulaic Hong Kong, complete with a regulation cast list of raffish correspondents, compromised British placemen and shadowy Chinese tycoons called Wo, Ho and So on. The detail does not even ring particularly true. Whoever heard of a journalist on a Hong Kong magazine with a “fabulous” salary?

Despite its lame start, the novel soon picks up. The second of three loosely connected sections is a sustained piece of fine writing about colonial life in the 1930s, the fall of Hong Kong to the Japanese, and the struggle to rebuild the colony after the end of the war. Most powerful of all are the parts dealing with the occupation itself, and the rigours, not just of life in internment, but of those who, like the hero of this middle part, Tom Stewart, had to carry on in their usual jobs under the glare of the Japanese authorities. The other main character is a nun, Sister Maria. The convolution of their relationship is engagingly, if too flimsily, sketched.

There are fewer stylistic rockets than were let off in “The Debt to Pleasure”, the writing owing more here to J.G. Farrell, another Englishman who ironised about imperial decline in the Far East. The last section returns briefly to Messrs Ho and Wo, to tie up their dealings so as not to leave a bagful of loose ends. But the middle—and longest—part is what makes Mr Lanchester's new novel worth reading. At its best, “Fragrant Harbour” strikes an elegiac note about Hong Kong and its past that will provide anyone who loves the place with an agreeably melancholic afternoon.

Fragrant Harbour.
By John Lanchester.
Putnam; 352 pages; $25.95.
Putnam; 352 pages; $25.95. Faber and Faber; £16.99

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Lord Weinstock

Jul 25th 2002
From The Economist print edition

Arnold Weinstock, a leading British industrialist, died on July 23rd, aged 77

Rex Features

ON THE day Lord Weinstock died, the rump of the company he created slid closer to bankruptcy, with sales falling further as debts rose. Its shares were down to four pence from £12.50 at their peak. He would have cried.

Lord Weinstock ran the General Electric Company (GEC) for 33 years from 1963, taking over rivals to build a business that was a colossus in Britain, dominating the defence, power and electronics industries at home, though no great success on a global scale. Seven years ago—when his son Simon, who he had hoped would succeed him, died of cancer—he left the company in the hands of a stolid Scottish accountant, Lord (George) Simpson, who was thought to be a safe pair of hands.

He was not. Lord Simpson promptly moved GEC out of its dingy rooms by Hyde Park Corner to a swanky office off Bond Street, flogged its defence arm to British Aerospace, and blew the proceeds on expensive telecoms-equipment-makers in America. Lord Weinstock's dull old GEC was to become a zingy growth company, riding the telecoms boom. Instead, GEC, renamed Marconi, became an early victim of the telecoms bust. Although he held his peace, Lord Weinstock looked on appalled as Marconi's shares melted down, destroying the company he created and wiping out much of his family's fortune. His friend Lord (James) Hanson said he probably died of a broken heart.

Lord Weinstock was not a man of vision. His risk-taking was reserved for the racecourse, where he was an atavistic gambler. At work he could not have been more different. He would sit in his dowdy office, below pictures of his racehorses, behind a huge desk, a Dickensian figure peering at columns of figures which told him how and where the cash was flowing around the company. He ruled the company with a clique of old cronies and his ever-present confidante, Sara Morrison, a well-connected Tory lady from Wiltshire where Lord Weinstock had his country house.

He relied on seven financial ratios, such as the ratio of working capital to sales, which told him how healthy or unhealthy each one of the 180-odd GEC companies was at any given time. At the first sign of trouble, he would pick up the telephone to bark at the hapless man in charge. He once fired a manager over the phone in front of the astonished head of British Rail, Sir Peter Parker, after Parker had complained about GEC locomotives breaking down.

He never visited factories and rarely left the country, except for the opera in Salzburg, the races at Longchamps or Deauville, and visits to Israel. He appointed figureheads, such as a former Tory cabinet minister, Lord Prior, as chairmen, in order to schmooze clients such as the Ministry of Defence. Margaret Thatcher had no time for him, preferring more swashbuckling entrepreneurs such as Lord Hanson. She thought he was yesterday's man, forever looking for state subsidies or protection.

He had a love-hate relationship with most of the brokers of the City of London: he loved to hate them, and they felt the same way about him. GEC's share price languished, because he refused to dash for growth with microchips or consumer electronics. But Lord Weinstock saw that such ventures lost millions for other European companies, such as Siemens or Philips. He stuck to solid things such as defence electronics, turbine-generators and telephone exchanges, mostly sold to governments in one guise or another. Spare cash was left in the bank rather than splurged on takeovers. When rivals, in turn, tried to

buy GEC in the late 1980s, he parked key businesses in stodgy joint ventures with French, German and American companies to render them impregnable.

Good at numbers, he was hopeless as a leader of people, being quick to chide and slow to praise. The cold manner may have come from his lonely upbringing. His Polish immigrant parents died when he was very young, leaving him to be brought up by a brother who was 20 years older. He escaped his working-class background through the London School of Economics and marriage into the Sobell electrical-appliance fortune, which took him to the top of GEC when it bought his father-in-law's business. Privately, he was witty and generous, listening to opera every morning as he shaved. On “Desert Island Discs”, a BBC radio programme, he chose only recordings conducted by his close friend Riccardo Muti.

There is irony in the timing of his death. GEC shares were popular only as a safe haven in recessions, because Lord Weinstock had a pile of several billions of pounds in cash at the bank. His virtues of conservatism and caution, prized in the sluggish early 1980s and 1990s, were derided during booms. But such qualities might have saved not only GEC, but many of the other companies now collapsing, like WorldCom, in a heap of fraudulent figures.

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The Economist food index

Jul 25th 2002
From The Economist print edition

The dollar-based food index has surged by 11% since mid-June, to its highest in three years. Grain prices have risen as hot and dry weather across America has shrivelled crops; the wheat harvest is forecast to be the lowest in 30 years. Cocoa prices have soared to 15-year highs.

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Overview

Jul 25th 2002
From The Economist print edition

Stockmarkets tumbled but then rallied midweek. America's Dow Jones Industrial Average fell by 4.1% over the week. The S&P 500 hit its lowest level since 1997, and the Nasdaq Composite fell by 7.7%. In Europe, Britain's FTSE 100 fell by 9.9% to a six-year low, and France's CAC 40 fell by 12.1%. Japan's Nikkei escaped the worst of the mayhem, falling only by 3.4%.

According to the Conference Board, **America's** index of leading economic indicators was unchanged in June. In May, consumers' appetite for imports drove America's trade deficit in goods and services to a record $37.6 billion, while the 12-month trade deficit in goods reached $430.3 billion. Consumer-price inflation slowed to 1.1% in the year to June, compared with 3.2% in the year to June 2001.

In the year to May, the **euro area** ran up a $72.7 billion trade surplus. Exports fell by 1% over the year, but imports fell by 8%.

The **Japanese** seemed to shrug off global economic worries. Consumer confidence rose to 39.3 in the second quarter, from 38.4 in the first quarter.

Sweden's unemployment rate rose to 4.0% in June, from 3.4% in May.

Despite its buoyant economy, **Australia's** consumer-price inflation edged down to 2.8% in the year to the second quarter.

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Output, demand and jobs

Jul 25th 2002
From The Economist print edition

% change on year ago

	GDP 1 qtr*	GDP 1 year	The Economist poll GDP forecasts 2002	The Economist poll GDP forecasts 2003	Industrial production latest	Retail sales (volume) latest	Unemployment % rate latest	Unemployment % rate year ago
Australia	+ 3.6	+ 4.2 Q1	+ 4.0	+ 3.9	+ 4.3 Q1	+ 5.0 Q1	6.5 Jun	6.9
Austria	+ 0.3	– 0.6 Q1	+ 1.2	+ 2.6	+ 3.5 Apr	– 1.1 Apr	4.1 May	3.5
Belgium	+ 2.0	– 0.3 Q1	+ 1.4	+ 3.1	– 2.5 May	+ 1.8 Apr	10.4 Jun†	9.9
Britain	+ 0.7	+ 1.1 Q1	+ 1.7	+ 3.0	– 1.9 May	+ 4.6 Jun	5.2 May‡	4.9
Canada	+ 6.0	+ 2.1 Q1	+ 3.2	+ 3.6	+ 1.3 Apr	+ 5.1 Apr	7.5 Jun	7.0
Denmark	+ 1.4	+ 1.1 Q1	+ 1.6	+ 2.4	+ 2.5 May	+ 1.5 Apr	5.1 May	5.2
France	+ 1.4	+ 0.3 Q1	+ 1.4	+ 2.9	+ 0.3 May	+ 2.3 May	9.1 May	8.6
Germany	+ 0.7	– 1.2 Q1	+ 0.9	+ 2.6	– 3.9 May	– 4.6 May	9.8 Jun§	9.3
Italy	+ 0.6	+ 0.1 Q1	+ 1.2	+ 2.8	– 1.5 May	– 1.2 Apr	9.0 Apr	9.5
Japan	+ 5.7	– 1.6 Q1	– 0.4	+ 1.2	– 2.0 May	– 2.2 May	5.4 May	4.9
Netherlands	+ 0.4	+ 0.3 Q1	+ 1.2	+ 2.8	– 2.0 May	+ 3.3 Apr	2.5 Jun**	2.0
Spain	+ 2.1	+ 2.0 Q1	+ 2.2	+ 3.3	– 1.7 May	na	11.4 May††	10.6
Sweden	+ 1.1	+ 1.1 Q1	+ 1.7	+ 2.9	+ 1.9 May	+ 4.9 May	4.0 Jun†	4.4
Switzerland	+ 0.7	+ 0.2 Q1	+ 1.1	+ 2.3	– 8.8 Q1	– 2.4 May	2.5 Jun†	1.6
United States	+ 6.1	+ 1.7 Q1	+ 2.8	+ 3.5	+ 0.2 Jun	+ 4.9 May	5.9 Jun	4.6
Euro area	+ 0.9	+ 0.3 Q1	+ 1.2	+ 2.8	– 1.2 May	+ 0.1 Apr	8.3 May††	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 0.6	– 2.0 Q1	na	na	+ 0.2 May	+ 2.4 Apr	9.0 Jun†	9.3
Greece	na	+ 4.3 Q1	na	na	+ 0.6 May	+19.3 Mar	na	na
Iceland	na	+ 3.12001	na	na	+ 3.3 2001	na	2.3 Jun†	1.2
Ireland	na	nil Q4	na	na	+16.5 May	+ 0.3 May	4.3 Jun	3.7
Luxembourg	na	+ 3.52001	na	na	+ 8.8 Apr	+ 9.9 Feb	2.7 May	2.4
New Zealand	+ 4.3	+ 4.0 Q1	na	na	+ 4.3 Q1	+ 8.2 Q1	5.3 Q1	5.4
Norway	– 1.1	+ 1.0 Q1	na	na	+ 7.9 May	+ 2.7 May	4.1 Q1	3.7
Portugal	+ 1.8	+ 1.0 Q4	na	na	+ 0.8 May	+ 0.5 May	4.4 Q1†	4.2

*% change at an annual rate. †Not seasonally adjusted. ‡Mar-May; claimant count rate 3.2% in May. §EU harmonised rate 8.3%. **Apr-Jun. ††Revised series.

Text refers only to the first 16 countries listed

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Prices and wages

Jul 25th 2002
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 2.8	Q2	+ 6.0	+ 2.7	+ 2.6	– 1.1	Q2	+ 5.6	+ 4.3	Q1	+ 5.6
Austria	+ 1.7	Jun	+ 2.8	+ 1.8	+ 1.7	– 1.7	Jun	+ 2.9	+ 2.4	Jun	+ 2.7
Belgium	+ 0.9	Jun	+ 2.9	+ 1.9	+ 1.6	+ 2.4	Jun	+ 0.9	+ 2.6	Q2	+ 2.6
Britain	+ 1.0	Jun	+ 1.9	+ 2.1	+ 2.5	nil	Jun	+ 0.4	+ 3.8	May	+ 4.5
Canada	+ 1.3	Jun	+ 3.3	+ 1.7	+ 2.2	– 2.6	May	+ 2.8	+ 2.8	Apr	+ 1.5
Denmark	+ 2.2	Jun	+ 2.3	+ 2.3	+ 2.1	– 1.2	Jun	+ 3.2	+ 4.0	Q1	+ 3.8
France	+ 1.4	Jun	+ 2.1	+ 1.8	+ 1.5	– 1.5	May	+ 2.8	+ 3.9	Q1	+ 4.3
Germany	+ 1.0	Jul	+ 2.6	+ 1.5	+ 1.4	– 1.5	Jun	+ 3.1	+ 2.1	Apr	+ 1.5
Italy	+ 2.2	Jun	+ 3.0	+ 2.3	+ 2.0	– 0.9	May	+ 2.9	+ 2.3	Apr	+ 2.6
Japan	– 0.9	May	– 0.7	– 1.0	– 0.4	– 1.0	Jun	+ 0.8	– 0.5	May	– 0.1
Netherlands	+ 3.4	Jun	+ 4.5	+ 3.6	+ 2.5	– 0.7	Apr	+ 6.2	+ 3.2	May	+ 4.9
Spain	+ 3.4	Jun	+ 4.2	+ 3.3	+ 2.8	+ 0.6	May	+ 2.7	+ 4.0	Q1	+ 3.4
Sweden	+ 2.0	Jun	+ 2.9	+ 2.4	+ 2.1	– 0.2	May	+ 2.6	+ 2.0	Apr	+ 3.1
Switzerland	+ 0.3	Jun	+ 1.6	+ 0.8	+ 1.2	– 1.7	Jun	+ 0.4	+ 2.5	2001	+ 1.3
United States	+ 1.1	Jun	+ 3.2	+ 1.7	+ 2.3	– 2.1	Jun	+ 2.6	+ 3.3	Jun	+ 4.1
Euro area	+ 1.7	Jun	+ 3.0	+ 2.2	+ 1.8	– 0.9	May	+ 3.7	+ 3.3	Q1	+ 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.1	Jun	+ 3.1	na	na	– 1.9	Jun	+ 1.9	+ 3.2	Q1	+ 5.1
Greece	+ 3.3	Jun	+ 3.9	na	na	+ 3.1	Apr	+ 5.1	na		na
Iceland	+ 4.1	Jul	+ 7.0	na	na	+ 6.2	Jul	+ 6.7	+ 6.9	Jun	+ 8.2
Ireland	+ 4.4	Jun	+ 5.3	na	na	+ 0.3	May	+ 3.4	+ 8.9	Q1	+ 7.4
Luxembourg	+ 1.7	Jun	+ 2.9	na	na	– 2.4	May	+ 1.4	nil	Apr	+ 8.4
New Zealand	+ 2.8	Q2	+ 3.2	na	na	+ 2.8	Q1	+ 8.0	+ 2.1	Q1	+ 1.8
Norway	+ 0.4	Jun	+ 3.8	na	na	–15.8	Jun	+ 3.5	+ 4.6	Q1	+ 4.4
Portugal	+ 3.4	Jun	+ 4.5	na	na	– 2.0	May	+ 5.5	na		na

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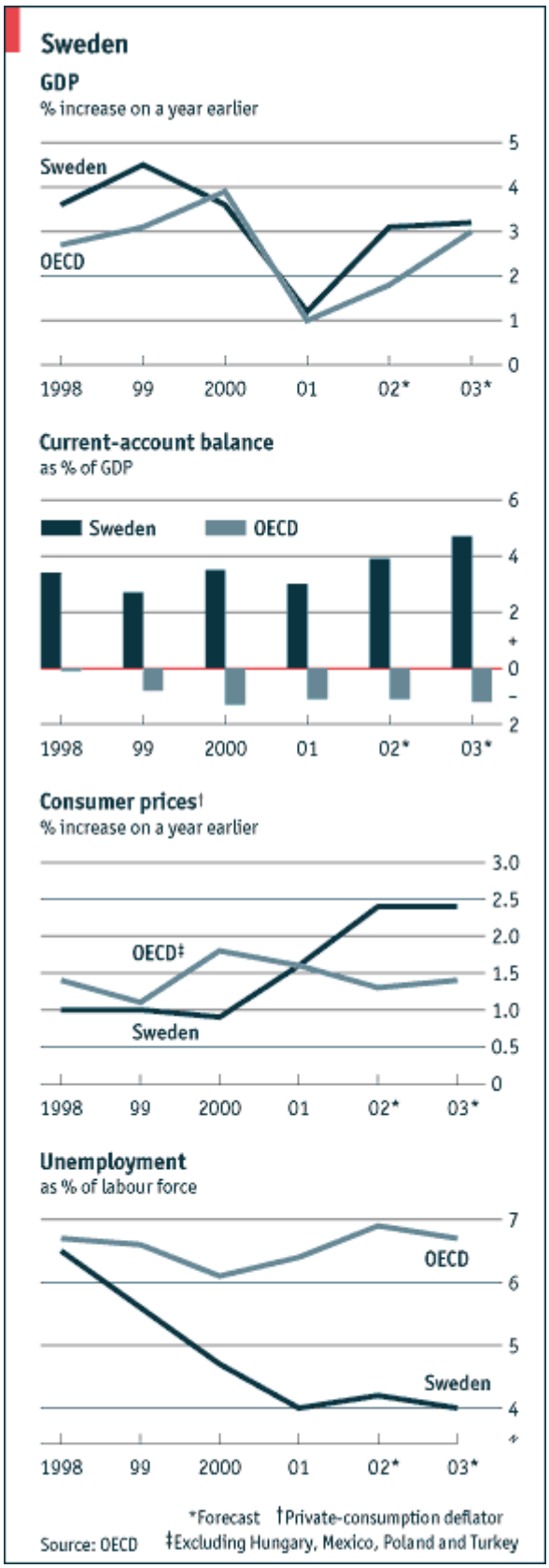
Sweden

Jul 25th 2002
From The Economist print edition

Sweden's economy slowed briefly but sharply in 2001, when GDP grew by 1.2%. With recovery beginning, says the OECD in a recent report, unemployment is already so low that wage inflation is expected to run at above 4.5%. There is a risk that growth could prove unsustainably strong if expansionary fiscal policy is extended to 2003. On the other hand, recovery could be slowed by continuing weak foreign demand for telecommunications equipment. As usual, the OECD points to areas ripe for structural reform. Marginal income-tax rates are high, and could be cut without loss of revenue by altering the tax structure and broadening the base of value-added tax. Joining the euro, of which Sweden is not a member, would reduce the country's ability to adapt to asymmetric economic shocks, but would remove one possible source of such shocks: exchange-rate fluctuations.



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Money and interest rates

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From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jul 24th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 3.7	+14.9	May	4.92	5.04	4.99	5.77	6.04	6.97‡
Britain	+ 9.4	+ 6.5	Jun	3.94	5.19	4.10	4.81	5.06	5.91
Canada	+14.5	+ 5.8	Jun	2.69	4.09	3.33	5.28	5.75	7.09
Denmark	+ 3.2	+ 7.3	Jun	3.57	4.82	4.15	4.93	5.18	6.88
Japan	+32.1	+ 3.4	Jun	0.03	0.01	0.02	1.31	1.38	1.37
Sweden	+ 2.5	+ 7.3	Apr	4.19	4.29	4.57	5.16	5.30	5.15
Switzerland	+ 8.5	+ 4.3	Jun	1.05	3.20	0.95	2.84	3.38	3.96
United States	+ 5.6	+ 7.2	Jun	1.75	3.54	2.26	4.40	5.17	6.72
Euro area†	+ 7.0	+ 7.8	May	3.38	4.47	3.61	4.66	4.90	5.83

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡New series. Benchmarks: US 30-year 5.45%, Japan No.240 1.33%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jul 25th 2002
From The Economist print edition

1995=100

	Jul 16th	Jul 23rd*	% change on one month	% change on one year
Dollar index				
All items	73.6	73.2	+ 3.8	+ 5.5
Food	76.1	76.3	+ 8.1	+ 8.1
Industrials				
All	70.3	69.1	– 2.1	+ 1.8
Nfa†	70.6	70.8	– 3.3	+ 5.7
Metals	69.9	67.6	– 1.0	– 1.5
Sterling index				
All items	73.9	73.9	– 0.4	– 4.2
Euro index				
All items	95.8	97.1	+ 1.5	– 7.0
Yen index				
All items	90.7	91.5	– 0.0	– 0.2
Gold				
$ per oz	318.00	318.60	+ 0.1	+18.5
West Texas Intermediate				
$ per barrel	27.75	26.36	+ 0.2	+ 1.0

* Provisional. † Non-food agriculturals.

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Stockmarkets

Jul 25th 2002
From The Economist print edition

Market indices

	Jul 24th	2002 high	2002 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	2,965.1	3,440.0	2,965.1	– 3.5	–13.8	–11.8	– 7.3
Austria (ATX)	1,121.3	1,357.2	1,114.4	– 7.9	–35.5	– 1.7	+ 9.7
Belgium (Bel 20)	1,979.3	2,899.8	1,979.3	–12.9	–46.2	–28.9	–20.6
Britain (FTSE 100)	3,777.1	5,323.8	3,777.1	– 9.9	–45.5	–27.6	–21.8
Canada (Toronto Composite)	6,382.1	7,958.1	6,161.1	– 4.7	–44.0	–17.0	–16.2
Denmark (KBX)	169.0	233.4	169.0	–13.6	–44.0	–24.8	–16.1
France (SBF 250)	2,067.7	3,081.9	2,067.7	–11.0	–52.9	–30.6	–22.6
(CAC 40)	3,023.7	4,688.0	3,023.7	–12.1	–56.3	–34.6	–27.1
Germany (Xetra DAX)	3,632.7	5,462.6	3,515.8	–11.2	–55.0	–29.6	–21.5
Italy (BCI)	1,077.8	1,513.0	1,077.8	– 9.1	–50.6	–24.8	–16.1
Japan (Nikkei 225)	9,947.7	11,979.9	9,420.9	– 3.4	–74.4	– 5.6	+ 6.4
(Topix)	976.6	1,139.4	922.5	– 1.2	–66.1	– 5.4	+ 6.7
Netherlands (AEX)	318.4	531.2	318.4	–16.1	–54.6	–37.2	–29.9
Spain (Madrid SE)	631.2	848.1	631.2	– 8.9	–44.9	–23.4	–14.6
Sweden (Affarsvarlden Gen)	143.1	236.8	143.1	–14.3	–64.2	–38.2	–32.4
Switzerland (Swiss Market)	4,607.8	6,694.1	4,607.8	–13.1	–45.2	–28.2	–18.1
United States (DJIA)	8,191.3	10,635.3	7,702.3	– 4.1	–30.1	–18.3	–18.3
(S&P 500)	843.4	1,172.5	797.7	– 6.9	–44.8	–26.5	–26.5
(Nasdaq Comp)	1,290.0	2,059.4	1,229.0	– 7.7	–74.4	–33.9	–33.9
Europe (FTSE Eurotop 300)*	862.3	1,279.7	862.3	–11.0	–49.4	–31.6	–23.7
Euro area (FTSE Ebloc 100)*	732.5	1,125.1	732.5	–12.6	–52.8	–34.1	–26.5
World (MSCI)†	776.2	1,024.4	756.7	– 7.9	–46.4	na	–22.7
World bond market (Salomon)‡	494.5	497.8	430.3	+ 0.1	– 0.7	na	+12.5

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jul 25th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† Jul 24th	year ago	Currency units per $ Jul 24th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2002‡
Australia	+ 0.4	May	− 9.5	Q1	− 3.3	− 3.6	71.0	71.6	1.86	1.97	2.93	1.85	1.60	0.1
Austria	− 2.4	Apr	− 1.3	May	− 2.2	− 2.0	100.8	100.1	1.01	1.14	1.58	–	0.87	-0.3
Belgium	+ 13.0	May	+ 13.0	Dec	+ 5.0	+ 5.3	100.1	98.7	1.01	1.14	1.58	–	0.87	nil
Britain	− 45.6	May	− 31.2	Q1	− 2.2	− 2.1	106.5	106.5	0.64	0.70	–	0.63	0.55	-0.8
Canada	+ 34.7	May	+ 14.7	Q1	+ 2.2	+ 2.3	74.9	78.4	1.58	1.54	2.49	1.57	1.36	1.0
Denmark	+ 7.1	May	+ 3.5	May	+ 1.9	+ 1.9	103.5	102.0	7.49	8.47	11.8	7.43	6.44	2.2
France	+ 8.5	May	+ 26.2	May	+ 1.8	+ 1.7	102.9	101.3	1.01	1.14	1.58	–	0.87	-2.0
Germany	+ 96.5	May	+ 19.8	May	+ 1.1	+ 1.1	100.1	98.2	1.01	1.14	1.58	–	0.87	-2.8
Italy	+ 9.3	May	− 1.4	Apr	+ 0.1	nil	73.4	72.3	1.01	1.14	1.58	–	0.87	-1.4
Japan	+ 76.3	May	+101.3	May	+ 2.7	+ 2.7	138.8	137.3	116	124	183	115	–	-8.0
Netherlands	+ 23.6	May	+ 13.6	Q1	+ 4.0	+ 4.1	99.2	97.6	1.01	1.14	1.58	–	0.87	0.1
Spain	− 36.8	Apr	− 16.6	Apr	− 2.2	− 1.9	75.0	74.0	1.01	1.14	1.58	–	0.87	-0.3
Sweden	+ 14.6	May	+ 8.4	May	+ 3.2	+ 3.3	74.3	74.6	9.60	10.6	15.1	9.53	8.26	2.1
Switzerland	+ 2.7	Jun	+ 25.7	Q1	+ 9.8	+10.1	115.9	109.1	1.46	1.71	2.29	1.45	1.25	na
United States	−430.3	May	−398.1	Q1	− 4.3	− 4.6	112.3	119.7	–	–	1.57	0.99	0.86	-1.0
Euro area	+ 72.7	May	+ 16.0	Apr	+ 0.4	+ 0.5	81.8	78.0	1.01	1.14	1.58	–	0.87	-1.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.5	May	+ 7.9	May	na	na	79.6	78.1	0.99	1.14	1.56	–	0.85	3.2
Greece	− 19.1	Dec	− 6.7	Mar	na	na	58.0	57.3	0.99	1.14	1.56	–	0.85	0.4
Iceland	+ 0.1	May	− 0.2	Q1	na	na	na	na	85.9	101	135	85.3	73.9	-0.5
Ireland	+ 33.2	Apr	− 1.1	Q4	na	na	89.3	86.8	0.99	1.14	1.56	–	0.85	0.1
Luxembourg	− 2.9	Apr	+ 0.9	Q4	na	na	100.1	98.7	0.99	1.14	1.56	–	0.85	2.2
New Zealand	+ 0.1	May	− 1.2	Q1	na	na	84.0	79.3	2.15	2.42	3.38	2.14	1.85	0.1
Norway	+ 25.3	Jun	+ 25.9	Apr	na	na	102.8	95.4	7.66	9.12	12.0	7.61	6.59	14.0
Portugal	− 12.9	Apr	− 9.3	May	na	na	90.2	89.1	0.99	1.14	1.56	–	0.85	-2.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD forecast.

Text refers only to the first 16 countries listed

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Overview

Jul 25th 2002
From The Economist print edition

GDP in the **Czech Republic** rose by 2.5% in the year to the second quarter, matching its growth rate of the previous three months.

Taiwan's industrial output rose by 8.4% in the year to June, its fourth month of positive annual growth. **Mexico's** industrial output rose by 0.9% in the year to May. Even so, it fell by 0.4% compared with the previous month.

Deflation continues to beset **Hong Kong**, where consumer prices have been falling year-on-year since November 1998. In the year to June, they fell by 3.3%. Pricing power is also weak elsewhere in Asia; consumer-price inflation in Singapore was just 0.1% in the year to June.

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The Economist poll of forecasters

Jul 25th 2002
From The Economist print edition

Every three months, *The Economist* polls a group of forecasters and averages their predictions for economic growth and current-account balances in 25 emerging economies. Our panel's prognosis for Argentina has darkened. They now predict that its economy will shrink by 12.3% this year, compared with a 4.7% forecast decline in January. Asia's financial crisis is now but a memory, with the panel expecting GDP to grow this year by 6.4% in South Korea, 4.0% in Thailand and 4.3% in Malaysia.

July

	Real GDP % change		Current account % of GDP	
	2002	2003	2002	2003
China	7.6	7.6	1.1	0.8
Hong Kong	2.3	4.3	8.4	8.0
India	5.7	6.0	–0.3	–0.4
Indonesia	3.7	4.3	2.9	3.0
Malaysia	4.3	5.9	6.8	6.1
Philippines	3.9	4.2	5.5	5.2
Singapore	4.3	5.9	22.0	20.1
South Korea	6.4	6.0	1.5	0.6
Taiwan	3.8	4.4	5.2	4.3
Thailand	4.0	4.4	3.8	3.1
Argentina	–12.3	–0.4	5.2	7.6
Brazil	1.9	3.6	–4.1	–3.9
Chile	2.7	4.7	–1.8	–1.7
Colombia	1.7	3.2	–2.6	–2.9
Mexico	1.6	4.3	–3.1	–3.2
Peru	3.6	4.1	–2.2	–2.7
Venezuela	–4.0	1.0	4.0	3.4
Egypt	2.1	3.5	–1.8	–1.4
Israel	–0.4	3.0	–1.7	–1.3
South Africa	2.5	3.2	nil	–0.4
Turkey	2.5	4.2	–0.6	–1.6
Czech Republic	3.2	4.1	–3.9	–4.1
Hungary	3.6	4.3	–3.4	–3.3
Poland	1.4	3.2	–4.2	–4.4
Russia	3.9	4.2	6.8	5.1

Sources: ABN Amro; Deutsche Bank; Economist Intelligence Unit; Goldman Sachs; HSBC; ING Financial Markets; J.P.Morgan Chase; Merrill Lynch; Salomon Smith Barney; UBS Warburg.

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Economy

Jul 25th 2002
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.0	Q2	+12.4	Jun	– 0.8	Jun	+27.9	Jun	+21.2	2001§	237.2	Apr
Hong Kong	– 0.9	Q1	–11.6	Q1	– 3.3	Jun	– 8.8	May	+14.5	Q1	112.4	Jun
India	+ 6.4	Q1	+ 3.8	May	+ 4.7	May	– 5.7	May	+ 1.4	Q1	54.7	Jun
Indonesia	+ 2.5	Q1	– 9.4	Q4	+11.5	Jun	+26.9	May	+ 8.4	Q3	27.9	May
Malaysia	+ 1.1	Q1	+ 4.0	May	+ 1.9	May	+13.2	May	+ 7.0	Q1	32.6	May
Philippines	+ 3.8	Q1	+17.0	Apr	+ 3.0	Jun	+ 2.5	May	+ 5.2	Mar	14.1	Jun
Singapore	+ 3.2	Q2	+17.0	May	+ 0.1	Jun	+ 5.7	Jun	+18.4	Q1	80.4	Jun
South Korea	+ 5.7	Q1	+ 7.7	May	+ 2.6	Jun	+ 8.7	Jun	+ 5.9	May	109.6	May
Taiwan	+ 0.9	Q1	+ 8.4	Jun	+ 0.1	Jun	+18.6	Jun	+22.0	Q1	148.2	Jun
Thailand	+ 3.9	Q1	+ 8.4	May	+ 0.2	Jun	+ 4.2	May	+ 6.5	May	34.5	May
Argentina	–16.3	Q1	–12.4	Jun	+28.4	Jun	+11.8	May	nil	Q1	10.2	May
Brazil	– 0.7	Q1	– 0.9	May	+ 7.7	Jun	+ 5.3	Jun	–19.0	May	32.9	May
Chile	+ 1.5	Q1	– 3.8	May	+ 2.0	Jun	+ 2.3	Jun	– 1.0	Q1	15.0	May
Colombia	+ 0.5	Q1	– 0.7	May	+ 6.3	Jun	+ 0.6	Mar	– 1.4	Q1	10.5	May
Mexico	– 2.0	Q1	+ 0.9	May	+ 4.9	Jun	– 9.2	Jun	–16.8	Q1	44.9	May
Peru	+ 4.3	May	+ 8.6	Apr	– 0.2	Jun	nil	May	– 1.0	Q1	8.7	May
Venezuela	– 4.2	Q1	–20.0	Mar	+19.6	Jun	+ 8.0	Q1	+ 1.8	Q1	6.7	Apr
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 2.7	Apr	– 8.4	Mar	– 0.1	Q1	12.6	Mar
Israel	– 4.2	Q1	+ 0.1	May	+ 6.6	Jun	– 6.4	Jun	– 2.3	Q1	24.8	Jun
South Africa	+ 2.1	Q1	+ 6.8	May	+ 8.9	Jun	+ 3.8	May	– 0.1	Q1	5.9	May
Turkey	+ 2.3	Q1	+11.0	May	+42.6	Jun	– 8.9	Apr	+ 2.6	Apr	22.0	May
Czech Republic	+ 2.5	Q2	+ 5.1	May	+ 1.2	Jun	– 2.5	Jun	– 2.4	Q1	21.2	Jun
Hungary	+ 2.9	Q1	– 0.7	May	+ 4.8	Jun	– 2.4	May	– 1.8	May	10.2	Jun
Poland	+ 0.5	Q1	+ 2.2	Jun	+ 1.6	Jun	–10.8	May	– 7.1	May	28.2	Jun
Russia	+ 3.7	Q1	+ 4.4	Jun	+14.9	Jun	+43.4	May	+31.2	Q1	39.8	Jun
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 6.3	Mar	+ 2.9	May	– 1.1	May	+ 0.3	2001†	4.1	May
Saudi Arabia	+ 1.2	2001	na		nil	Mar	+44.1	2001	+14.5	2001	18.4	May

*Excluding gold, except Singapore; IMF definition. †Year ending June. §Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Jul 25th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jul 24th		Dec 31st 2001	
	Jul 24th	year ago	Jul 24th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.0	na	1,745.0	– 1.7	+ 1.9	+ 1.9
Hong Kong	7.80	7.80	12.3	1.80	9,972.0	– 3.5	– 12.5	– 12.5
India	48.7	47.1	76.5	5.84	3,107.5	– 3.4	– 4.7	– 5.6
Indonesia	9,063	10,050	14,254	15.53	460.0	– 4.0	+ 17.3	+ 34.7
Malaysia	3.80	3.80	5.98	3.25	715.1	– 2.2	+ 2.7	+ 2.7
Philippines	50.7	53.5	79.8	6.56	1,149.0	– 0.7	– 1.6	+ 0.1
Singapore	1.74	1.82	2.74	0.75	1,522.8	– 3.8	– 6.2	– 0.6
South Korea	1,165	1,305	1,833	4.89	721.4	– 6.5	+ 4.0	+ 17.2
Taiwan	33.2	34.8	52.3	2.05	5,039.5	– 4.0	– 9.2	– 4.4
Thailand	41.2	45.7	64.7	2.00	374.4	– 5.0	+ 23.2	+ 32.4
Argentina	3.64	1.00	5.73	50.10	364.2	– 3.0	+ 23.3	– 66.1
Brazil	2.94	2.49	4.62	17.89	9,937.4	– 7.6	– 26.8	– 42.4
Chile	702	663	1,105	3.24	4,749.1	+0.1	– 12.0	– 17.2
Colombia	2,573	2,304	4,046	7.99	1,204.6	– 1.1	+ 12.5	– 0.4
Mexico	9.71	9.16	15.3	6.82	6,010.4	– 6.1	– 5.7	– 10.9
Peru	3.54	3.50	5.56	2.90	1,184.0	+1.2	+ 0.7	– 1.9
Venezuela	1,319	724	2,074	33.54	7,046.9	– 1.9	+ 7.3	– 38.4
Egypt	4.65	3.95	7.31	7.20	5,424.9	– 2.7	+ 2.9	+ 1.3
Israel	4.69	4.19	7.38	6.40	350.2	– 5.4	– 21.6	– 26.3
South Africa	10.3	8.20	16.2	12.40	9,393.5	– 8.7	– 10.0	+ 4.8
Turkey	1,695,000	1,325,000	2,666,066	44.00	9,715.0	– 7.7	– 29.5	– 39.5
Czech Republic	30.4	38.5	47.9	3.35	406.6	– 5.1	+ 3.0	+ 20.4
Hungary	247	281	388	9.65	6,589.8	–11.7	– 7.6	+ 3.0
Poland	4.10	4.20	6.45	8.82	12,748.5	– 8.4	– 8.4	– 11.8
Russia	31.5	29.2	49.6	23.00	325.0‡	–13.7	+ 29.3	+ 25.0
EMF (MSCI)*	1.00	1.00	1.57	na	302.1	– 7.0	na	– 4.8
EMBI+†	1.00	1.00	1.57	na	200.4	– 1.6	na	+ 0.0

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends.*

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